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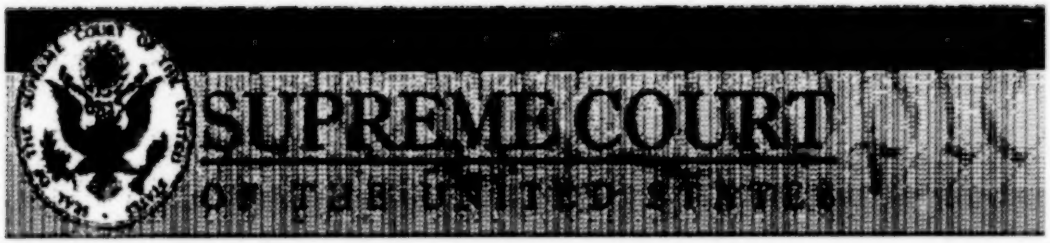

No. 13-485

Title:	Comptroller of the Treasury of Maryland, Petitioner
	v.
	Brian Wynne, et ux.
Docketed:	October 17, 2013
Linked with 13A126	
Lower Ct:	Court of Appeals of Maryland
Case Nos.:	(107, September Term, 2011)
Decision Date:	January 28, 2013
Rehearing Denied:	May 17, 2013

Questions Presented

~~Date~~	~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~
Jul 23 2013	Application (13A126) to extend the time to file a petition for a writ of certiorari from August 15, 2013 to October 14, 2013, submitted to The Chief Justice.
Jul 30 2013	Application (13A126) granted by The Chief Justice extending the time to file until October 14, 2013.
Oct 13 2013	Petition for a writ of certiorari filed. (Response due November 18, 2013)
Nov 6 2013	Consent to the filing of amicus curiae briefs, in support of either party or of neither party, received from counsel for the petitioner.
Nov 15 2013	Order extending time to file response to petition to and including December 18, 2013.
Nov 18 2013	Brief amici curiae of International Municipal Lawyers Association, et al. filed.
Nov 26 2013	Brief of respondents Brian Wynne, and Karen Wynne in opposition filed.
Dec 10 2013	Reply of petitioner Comptroller of the Treasury of Maryland filed.
Dec 11 2013	DISTRIBUTED for Conference of January 10, 2014.
Jan 13 2014	The Solicitor General is invited to file a brief in this case expressing the views of the United States.
Apr 4 2014	Brief amicus curiae of United States filed.
Apr 21 2014	Supplemental brief of respondents Brian Wynne, and Karen Wynne filed.
Apr 22 2014	DISTRIBUTED for Conference of May 15, 2014.
May 19 2014	DISTRIBUTED for Conference of May 22, 2014.
May 27 2014	Petition GRANTED.
Jun 5 2014	Record received from Court of Appeals of Maryland. 1 Box.
Jun 11 2014	Consent to the filing of amicus curiae briefs, in support of either party or of neither party , received from counsel for the petitioner.
Jun 13 2014	Consent to the filing of amicus curiae briefs, in support of either party or of neither party, received from counsel for the respondents.

Jul 10 2014	The time to file the joint appendix and petitioner's brief on the merits is extended to and including July 29, 2014.
Jul 10 2014	The time to file respondents' brief on the merits is extended to and including September 19, 2014.
Jul 29 2014	Joint appendix filed.
Jul 29 2014	Brief of petitioner Comptroller of the Treasury of Maryland filed.
Aug 1 2014	Brief amicus curiae of United States filed.
Aug 5 2014	Brief amici curiae of International Municipal Lawyers Association, et al. filed.
Aug 5 2014	Brief amicus curiae of Multistate Tax Commission filed.
Aug 26 2014	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
Sep 4 2014	SET FOR ARGUMENT on Wednesday, November 12, 2014.
Sep 19 2014	CIRCULATED
Sep 19 2014	Brief of respondents Brian Wynne, et ux. filed. (Distributed)
Sep 26 2014	Brief amicus curiae of American Legislative Exchange Council filed. (Distributed)
Sep 26 2014	Brief amicus curiae of American Association of Attorney-Certified Public Accountants, Inc. filed. (Distributed)
Sep 26 2014	Brief amicus curiae of National Association of Publicly Traded Partnerships filed. (Distributed)
Sep 26 2014	Brief amicus curiae of Maryland Chamber of Commerce filed. (Distributed)
Sep 26 2014	Brief amicus curiae of Chamber of Commerce of the United States of America filed. (Distributed)
Sep 26 2014	Brief amici curiae of Michael S. Knoll, and Ruth Mason filed. (Distributed)
Sep 26 2014	Brief amicus curiae of Council on State Taxation filed. (Distributed)
Sep 26 2014	Brief amicus curiae of Tax Foundation filed. (Distributed)
Sep 26 2014	Brief amici curiae of National Federation of Independent Business Small Business Legal Center, et al. filed. (Distributed)
Sep 26 2014	Brief amicus curiae of Tax Executives Institute, Inc. filed. (Distributed)
Sep 26 2014	Brief amicus curiae of Tax Economists filed. (Distributed)
Oct 15 2014	Application (14A403) to extend the time to file a reply brief on the merits from October 20, 2014 to October 23, 2014, submitted to The Chief Justice.
Oct 16 2014	Application (14A403) granted by The Chief Justice extending the time to file until October 23, 2014.
Oct 20 2014	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
Oct 21 2014	Application (14A426) to extend further the time within which to file petitioner's reply brief on the merits from October 23, 2014 to October 27, 2014, submitted to The Chief Justice.
Oct 22 2014	Application (14A426) granted by The Chief Justice extending the time to file until October 24, 2014.
Oct 24 2014	Reply of petitioner Comptroller of the Treasury of Maryland filed. (Distributed)
Nov 12 2014	Argued. For petitioner: William F. Brockman, Acting Solicitor General, Baltimore, Md.; and Eric J. Feigin, Assistant to the Solicitor General, Department of Justice, Washington, D. C. (for United States, as amicus curiae.) For respondents: Dominic F. Perella, Washington, D. C.

PETITION FOR WRIT OF CERTIORARI

FILED
OCT 13 2013
OFFICE OF THE CLERK

No. 13-485

In The
Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,

Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals of Maryland

PETITION FOR A WRIT OF CERTIORARI

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OCTOBER 2013

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QUESTION PRESENTED

Does the United States Constitution prohibit a state from taxing all the income of its residents—wherever earned—by mandating a credit for taxes paid on income earned in other states?

PARTIES TO THE PROCEEDINGS

The petitioner is the Comptroller of the Treasury of Maryland, Peter Franchot. The respondents are Brian Wynne and Karen Wynne.

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PETITION FOR A WRIT OF CERTIORARI

The Maryland State Comptroller of the Treasury respectfully petitions this Court for a writ of certiorari to review the judgment of the Court of Appeals of Maryland.

OPINIONS BELOW

The opinion of the Court of Appeals of Maryland is reported at 431 Md. 147. App. 1-52. The opinion and order of the Circuit Court for Howard County are unreported. App. 53-129. The order and oral ruling of the Maryland Tax Court also are unreported. App. 130-41.

JURISDICTION

The Court of Appeals of Maryland issued its decision on January 28, 2013. App. 1-49. On May 17, 2013, the Court of Appeals issued an opinion clarifying its decision, denying the Comptroller's timely request for rehearing, and staying the effect of the court's judgment pending this Court's disposition of a petition for a writ of certiorari. App. 50-52. On July 30, 2013, the Chief Justice extended the time for filing this petition to and including October 14, 2013. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution provides:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. . . .

U.S. Const. art. I, § 8, cl. 3.

The Due Process Clause of the Fourteenth Amendment to the United States Constitution provides:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law. . . .

U.S. Const. amend. XIV, § 1.

The Maryland statutory provisions that authorize the personal income taxes and the tax credit at issue in this case are reproduced in the appendix. App. 142-44.

STATEMENT

The Maryland Court of Appeals has reached the unprecedented conclusion that a state is constitutionally prohibited from collecting personal income taxes from its own residents to the extent that the income was earned from sources in another state where the income is subject to tax by that state. That holding is directly contrary to numerous decisions of

this Court recognizing "the rule, accepted interstate and internationally, that a sovereign may tax the entire income of its residents." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 453 (1995).

1. Maryland taxes the entire income of its residents by imposing a state income tax with two components: a "State tax," Md. Code Ann., Tax-General ("Tax-Gen.") § 10-102, and a "County tax," Tax-Gen. § 10-103(a)(1). *See Frey v. Comptroller*, 422 Md. 111, 125 (2011) (describing Maryland income tax scheme for individual taxpayers). As relevant here, the State tax "is imposed on the Maryland taxable income of each individual." Tax-Gen. § 10-102 (emphasis added). The County tax rate varies by county; a state resident is taxed at the rate for the county in which the individual "is domiciled" or "maintains a principal residence" on "the last day of the taxable year." Tax-Gen. §§ 10-101(k)(1)(i)-, 10-103(a)(1). State law provides for a tax credit for taxes paid to other states, but this credit applies only to the State tax component; it does not serve to offset a resident's County tax obligation. Tax-Gen. § 10-703(a); *see Comptroller v. Blanton*, 390 Md. 528, 540 (2006).

2. Respondents Brian and Karen Wynne are a married couple with five children residing in Howard County, Maryland. App. 8. In 2006, the tax year at issue, Mr. Wynne held a 2.4% ownership interest in Maxim Healthcare Services, Inc. ("Maxim"), a Maryland Subchapter-S corporation based in Howard County that provides home healthcare, medical staffing, and other services nationwide. App. 8-9, 55-56.

a. On their 2006 joint return, the Wynnes reported taxable net income of approximately $2.7 million, more than half of which represented Mr. Wynne's share of the distributions from Maxim's earnings. App. 56. The State component of the Maryland tax on the Wynnes' net income, before allowance of any credits, was $126,636, *see* Tax-Gen. § 10-105(a)(2). App. 56. However, the Wynnes claimed a credit against this component, in the amount of $84,550, for taxes Maxim had paid to 39 other states on Mr. Wynne's share of Maxim's income earned in those states.[1] Neither Maxim nor the Wynnes reported having paid income taxes to any county or local government outside Maryland, App. 9, and the Wynnes did not claim a credit against the County component of their Maryland taxes, App. 56.

b. The Comptroller determined that the Wynnes had underpaid their 2006 taxes, and issued a deficiency assessment. A hearing officer affirmed the assessment. App. 10.

---

[1] Some of these states recognized Maxim's election to be taxed as an S-corporation and accorded "pass-through" treatment to its income, as the federal government and Maryland do, *see* 26 U.S.C. §§ 1361, 1366; Tax-Gen. §§ 10-102.1(b), 10-104(6); these states required Maxim to file composite returns on behalf of their owners. Other states required Maxim to file a corporate tax return instead of or in addition to the composite return filed on behalf of Maxim's shareholders. The Maryland personal income tax credit invoked by the Wynnes allows a credit for a resident's share of the taxes paid by an S-corporation to another state, regardless of whether the state accords pass-through treatment to the entity. *See* Tax-Gen. § 10-703(c)(1), (2).

c. In October 2008, the Wynnes appealed to the Maryland Tax Court. Initially, the Wynnes disputed only the Comptroller's calculation of the State component of their income tax liability and did not assert that the State's failure to extend the credit to the County component of the tax violated any State or federal constitutional provision. In April 2009, however, the Wynnes amended their appeal petition to assert, as an alternative to their statutory argument, that the tax credit statute, as applied by the Comptroller and as construed by Maryland courts, violates the Commerce Clause of the United State Constitution. The Tax Court rejected both arguments and affirmed the assessment. App. 136, 140.

3.a. In January 2010, the Wynnes sought judicial review of the Tax Court's decision in the Circuit Court for Howard County. App. 54. Abandoning their statutory argument, the Wynnes argued that the dormant Commerce Clause requires Maryland to extend the credit for taxes paid to other states to the County component as well as the State component of the tax. App. 63.

On June 29, 2011, the circuit court ruled that § 10-703(a) of the Tax-General Article violates the Commerce Clause of the United States Constitution by authorizing a credit for taxes paid to other states that offsets a Maryland resident's State income tax liability, but does not offset his or her local income tax liability. The court therefore reversed the Tax Court's ruling upholding the deficiency assessment against the Wynnes. App. 126.

b. The Comptroller appealed. The Wynnes then petitioned for review by the Maryland Court of Appeals before consideration in the intermediate appellate court, and the Court of Appeals granted the petition. 424 Md. 291 (2012).

On January 28, 2013, the Court of Appeals issued a decision holding that "the failure of the Maryland income tax law to allow a credit against the county tax for a Maryland resident taxpayer with respect to pass-through income of an S corporation that arises from activities in another state and that is taxed in that state violates the dormant Commerce Clause of the federal Constitution." App. 32.

The Court of Appeals rejected the Comptroller's assertion that, under this Court's precedent, "the Wynnes are subject to Maryland income taxes because of their status as Maryland residents and not because of their activities in intrastate or interstate commerce"; the Court of Appeals labeled that proposition "a false dichotomy." App. 15. Instead, the court opined, the Wynnes are subject to the State income tax "because they are Maryland residents *and* because they have income derived from intrastate and interstate activities[.]" App. 15 (emphasis in original). The court observed that, since "other states may also tax some of that same income because it derives from activities in those state[s]," the issue before the court "concerns the constitutional constraint on the otherwise overlapping power to tax such income." App. 15.

Based on its belief that the Constitution prohibits "double taxation" of income earned in interstate commerce, the court rejected the Comptroller's

arguments relying on this Court's precedents establishing that a state may tax all the income of its residents, wherever earned; the court also dismissed authority from other state courts of last resort affirming this principle in analogous contexts. App. 4, 15. Those conflicting decisions, the court concluded, "are not persuasive," because they "fail to distinguish the constraints on state taxation imposed by the dormant Commerce Clause from those imposed by the Due Process Clause or . . . are otherwise distinguishable from the case." App. 15 (citing *Stelzner v. Commissioner of Revenue*, 621 N.W.2d 736 (Minn. 2001); *Luther v. Commissioner of Revenue*, 588 N.W.2d 502 (Minn. 1999); *Tamagni v. Tax Appeals Tribunal*, 695 N.E.2d 1125 (N.Y. 1998); *Keller v. Department of Revenue*, 872 P.2d 414 (Or. 1994)).

4. The Comptroller moved for reconsideration and to stay enforcement of the judgment. On May 17, 2013, the Court of Appeals denied reconsideration and issued a brief opinion in which it clarified two points raised by its decision and granted the Comptroller's request for a stay pending this Court's disposition of a petition for a writ of certiorari. App. 50-52.

REASONS FOR GRANTING THE PETITION

For more than 90 years this Court has recognized the "well-established principle" that "a jurisdiction . . . may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Chickasaw Nation*, 515 U.S. at 462-63 (emphasis in original); *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937); *Lawrence v. State Tax Commission*, 286 U.S. 276, 280-81 (1932). As the Court has explained, a state's broad

taxing power over its residents "is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received," all of which "are rights and privileges which attach to domicil within the state." *Cohn*, 300 U.S. at 313. It is commonly understood that each state assumes special responsibilities for the care and education of its own residents, obligations that are not generally shared by other states where a taxpayer works or conducts business but does not reside. Of course, unlike other persons who might be affected by a state's tax scheme, residents have the political power to relieve themselves of unwarranted tax burdens: if they are displeased with particular tax policies in their home state, they are free "to complain about and change the tax through the [state's] political process." *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989).

The decision below directly conflicts with these fundamental precepts. Drawing on cases involving taxation of nonresidents and multistate business enterprises, the Court of Appeals concluded that the Commerce Clause imposes restrictions on a state's power to tax its own residents; accordingly, the court ruled, Maryland *cannot* tax all of its resident's income if the resident paid taxes on that income to another State. The court made no effort to explain why the contrary decisions of this Court were no longer good law; instead, the Court of Appeals undertook its novel analysis as if it had uncovered a constitutional problem that this Court had somehow repeatedly overlooked. Based on its misunderstanding of established principles, the Court of Appeals has mandated a new tax system under which certain Maryland residents,

including the Wynnes, can obtain all the benefits granted to other Maryland residents, without having to pay their full share of the bill.

Aside from being wrong on the merits, the decision below is also of great importance. As a result of the decision, Maryland faces a significant loss of revenue that will amount to tens of millions of dollars annually. Furthermore, although most states, like Maryland, offer credits for income taxes paid to sister states, other jurisdictions have opted to limit the scope or availability of the credit, based on the historical understanding that the States' taxing power extends to all of their residents' income. The Constitution furnishes no basis for invalidating Maryland's longstanding tax system or casting doubt on the validity of similar regimes maintained in other states. The Court should grant certiorari to review the Court of Appeals' decision.

I. THE DECISION BELOW IS DIRECTLY CONTRARY TO NUMEROUS DECISIONS OF THIS COURT.

In multiple decisions spanning the better part of the Twentieth Century, this Court has established and reaffirmed that a State may tax *all* of the income of its resident taxpayers, wherever earned. *Chickasaw Nation*, 515 U.S. at 462-63; *State Tax Comm'n of Utah v. Aldrich*, 316 U.S. 174, 179 (1942); *Guaranty Trust Co. of New York v. Virginia*, 305 U.S. 19, 23 (1938); *Curry v. McCanless*, 307 U.S. 357, 368 (1939); *Cohn*, 300 U.S. at 313; *Lawrence*, 286 U.S. at 281; *Maguire v. Trefry*, 253 U.S. 12, 17 (1920); *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). The origins of this principle actually extend much further back in the Court's

history. *See, e.g.*, *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 429 (1819) ("It is obvious, that [the power to tax] is an incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a State extends, are objects of taxation.").

In this case involving only a state's taxation of its own residents, the decision of the Maryland Court of Appeals departs from both the letter and the rationale of this Court's established precedent. If left unreviewed, that departure will impose immense costs on the State and its citizens and will deprive the State of the ability to pursue the tax policy that has been chosen by Maryland's legislature and maintained for four decades. Though this Court's precedents recognize that the States possess the authority to tax the income of both residents and nonresidents, *see Curry*, 307 U.S. at 368 ("[I]ncome may be taxed both by the state where it is earned and by the state of the recipient's domicile."), a state's power to tax its own residents is by far the broader of the two prerogatives and has been described as "plenary." *Aldrich*, 316 U.S. at 179. Thus, under the universally-accepted rule, a state "may, and does, exert its taxing power over [residents'] income from all sources, whether within or without the State"; by contrast, the States' taxing power with respect to nonresidents "extends only to their property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources." *Shaffer*, 252 U.S. at 57.

This Court's precedents further establish that the States' authority to "tax *all* the income of its residents,

even income earned outside the taxing jurisdiction," *Chickasaw Nation*, 515 U.S. at 462-63, is an attribute of the sovereignty they possess in our federalist system, and the Court has explained that this broad taxing power necessarily follows from the unique relationship between a state and its own residents. *See id.* at 463. "'Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government.'" *Id.* (quoting *Cohn*, 300 U.S. at 313). The States' power to ensure that these costs of government are shared broadly is "founded upon the protection afforded to the recipient of the income by the state, in his person, on his right to receive the income, and in his enjoyment of it when received," *Lawrence*, 286 U.S. at 281, as well as the person's "[e]njoyment of privileges of residence in the state and the attendant right to invoke the protection of its laws," *Cohn*, 300 U.S. at 312-13.

Although states "sometimes elect not to" exercise the full extent of their "authority to tax all income of their residents" and may instead choose to "credit income taxes paid to other sovereigns," this Court has recognized that the determination to do so "is an independent policy decision," *Chickasaw Nation*, 515 U.S. at 463 n.11; the Court has never suggested that a state must extend such a credit or exemption to its own residents as a matter of constitutional compulsion. Rather, this Court has rejected the notion that the Constitution affords "'immunity from taxation by more than one state'"; thus, "'[a] state is free to pursue its own fiscal policies'" in taxing its own residents, "'unembarrassed by the Constitution,'" notwithstanding the possibility of "double taxation" of

income in more than one jurisdiction. *Aldrich*, 316 U.S. at 176, 178 (citations omitted).

In none of these decisions affirming the states' broad taxing power with respect to their own residents did this Court so much as hint that this power was somehow negated by emanations from the negative Commerce Clause. Indeed, the Court's jurisprudence construing the Commerce Clause suggests that it is an unlikely source for such a restriction on state taxing power. As this Court has instructed, the Commerce Clause does not serve to "protect state residents from their own state taxes." *Goldberg*, 488 U.S. at 266.

The decision below, by focusing only on the Wynnes' income-producing activities, ignores completely the benefits that the Wynnes receive as residents of Maryland. These benefits are nothing less than the very reason for having a state income tax, as a means for furnishing "'the protection afforded to the recipient of the income by the government of the [State] of his residence'"—a government that "'provides for him all the advantages of living in safety and in freedom and of being protected by law" and that "gives security to life, liberty and the other privileges of dwelling in a civilized community.'" *Maguire*, 253 U.S. at 14 (citation omitted). Despite this Court's rejection of the notion of constitutional immunity from "double taxation," *Aldrich*, 316 U.S. at 176, Maryland's Court of Appeals held that "the Commerce Clause of the Federal Constitution sets certain constraints" on "the possibility of what might be termed 'double taxation' when both the state of the taxpayer's residence and the state where the income was generated tax the same income." App. 4. That holding cannot be reconciled

with this Court's numerous precedents recognizing each state's authority to exercise what this Court has deemed "the most plenary of sovereign powers," which is the power to tax the state's own residents. *Lawrence*, 286 U.S. at 279.

II. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER STATE HIGH COURTS AFFIRMING THE AUTHORITY OF A STATE TO TAX ITS RESIDENTS ON INCOME EARNED IN AND TAXED BY OTHER STATES.

Numerous state courts of last resort and intermediate appellate courts have issued reported decisions adhering to this Court's precedents instructing that states may tax *all* of the income of their residents wherever earned. *See, e.g., Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 803-804 (Conn. 1999) (holding that state may constitutionally tax entire income of resident trusts, wherever generated); *Idaho Tax Comm'n v. Stang*, 25 P.3d 113, 116-117 (Idaho 2001) (holding that state may constitutionally tax resident's Individual Retirement Account distribution even though it had already been taxed by another state; any "tax credit must come from the legislature, not from the judiciary"); *In re Barton-Dobenin*, 9 P.3d 9, 13-14 (Kan. 2000) (holding that resident taxpayer may be taxed on entire income, without credit for income taxes paid to foreign country because "the tax is a personal income tax imposed on a resident of the state of Kansas for the purpose of reimbursing the state for the protections it affords the individual"); *Stelzner v. Commissioner of Revenue*, 621 N.W.2d 736, 740-742 (Minn. 2001) (holding that state may constitutionally tax the entire income of its non-

domiciliary residents); *Luther v. Commissioner of Revenue*, 588 N.W.2d 502, 511 (Minn. 1999) (holding that state may constitutionally tax the income of non-domiciliary resident); *Keller v. Department of Revenue*, 872 P.2d 414, 416 (Or. 1994) ("Oregon is entitled to tax the income of its residents."); *see also Zunamon v. Zehnder*, 719 N.E.2d 130, 137-138 (Ill. App. 1999) (holding that state may constitutionally tax all the income of its own residents and therefore is not required to grant residents a credit for taxes paid to other states).

In *Tamagni v. Tax Appeals Tribunal*, for example, the taxpayers, like the Wynnes, were taxed because of their status as residents of the taxing state, not as the result of any interstate activities. *See* 695 N.E.2d 1125, 1132 (N.Y. 1998). Relying on the states' broad powers to tax their own residents, the court held that denial of the credit was a constitutional exercise of New York's taxing authority. *See id.* at 1126. Contrary to the reasoning of the Maryland Court of Appeals below, the *Tamagni* court explained that, because "[t]he New York income tax is based upon a taxpayer's resident status, without regard to any specific commercial or economic transaction or activity," and "without regard to their activities in other States," the dormant Commerce Clause was not implicated. *Id.* at 1130, 1134; *see also id.* at 1134 ("The inapplicability of dormant Commerce Clause analysis to State resident income taxation is further supported by both historical precedent and the fundamental State sovereignty interest at stake.").

III. THE QUESTION PRESENTED IS OF EXCEPTIONAL IMPORTANCE.

Though the difference between the amount the Wynnes claimed as a credit against their Maryland income taxes and the amount allowed under Maryland's credit statute is small—slightly more than $25,000—the fiscal consequences of the decision below are profound. According to revenue projections set forth in an affidavit submitted in support of the Comptroller's request for a stay of the lower court's judgment, the more generous tax credits that the Court of Appeals has held to be constitutionally mandated would reduce overall personal income tax collections by $45,000,000 to $50,000,000 annually in future tax years. The retrospective impact of these enlarged tax credits, if claimed and allowed under Maryland's tax refund statute, could potentially amount to $120,000,000 in additional lost revenues that the State will be forced to generate from other sources. For some Maryland counties with large numbers of residents who earn income from out-of-state sources, the projected revenue shortfall is between 2 and 3 percent of total personal income tax collections. Unless this Court grants review, the Court of Appeals' unprecedented and improvident departure from the constitutional principles enunciated by this Court will force Maryland and its local governments to endure that loss of revenue while preventing the State from exercising its heretofore undoubted sovereign authority "to pursue its own fiscal policies'" with respect to its own residents. *Aldrich*, 316 U.S. at 178.

If the decision of the Maryland Court of Appeals were correct, tax schemes in other jurisdictions across

the nation would be rendered constitutionally suspect. For example, the State of New York similarly administers a "piggyback" income tax to fund municipal governments; like Maryland, New York permits its residents to claim a credit for taxes paid to other states, but does not allow a credit to offset the municipal income tax. *See* N.Y. Tax Law §§ 601, 620, 1301, 1310. The premise embraced by the Court of Appeals, if adopted by other courts, would potentially also affect the more than 23 million Americans who reside in nearly 5,000 local jurisdictions that impose an income tax.[2] For example, the Tax Foundation reports that a personal income tax on residents' income is imposed by 91 counties in Indiana, 593 municipalities in Ohio, and 2,469 municipalities in Pennsylvania. Typically, these jurisdictions, like Maryland, assess their tax on residents' entire income, irrespective of its source.[3] In the proceedings below, neither party was able to identify a single one of these jurisdictions that allows its residents a credit against their personal income tax for taxes paid to other states, and the Constitution offers no reason for requiring such a credit.

This Court's review is warranted to prevent the serious threat to the Maryland Treasury posed by the unprecedented decision below and to avoid casting

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[2] *See* Joseph Henchman & Jason Sapia, *Tax Foundation Fiscal Fact No. 280* (2011), *available at* http://taxfoundation.org/article/local-income-taxes-city-and-county-level-income-and-wage-taxes-continue-wane (last visited Oct. 14, 2013).

[3] *See, e.g.*, Mich. Comp. Laws §§ 141.612, 141.613; Phila. Income Tax Reg. §§ 221, 222.

doubt on the settled expectations of taxing authorities throughout the United States.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX

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APPENDIX A

IN THE COURT OF APPEALS OF MARYLAND

No. 107

September Term, 2011

[Filed January 28, 2013]

MARYLAND STATE COMPTROLLER OF THE TREASURY	)
v.	)
BRIAN WYNNE, ET UX.	)

Bell, C.J.
Harrell
Battaglia
Greene
Adkins
Barbera
McDonald,

JJ.

Opinion by McDonald, J.
Battaglia and Greene, JJ., dissent.

Federal and Maryland law allow for the attribution of corporate income to the corporation's shareholders – without being taxed at the corporate level – in defined circumstances. In particular, the income of a Subchapter S corporation is deemed to "pass through" to the shareholders who are then directly taxed on that income. Some or all of that income may be generated outside the state in which a shareholder resides.

The Maryland income tax law reaches all of the income of a Maryland resident. The State income tax law allows a credit against an individual's State tax liability for income taxes paid to other states based on the income earned in those states. However, that credit takes no account of, and cannot be taken against, the portion of the Maryland income tax known as the "county income tax."

This case poses the question whether the failure to allow a credit violates the federal Constitution when a portion of a Maryland resident taxpayer's income consists of significant "pass-through" income generated by a Subchapter S corporation in other states, apportioned to the taxpayer, and taxed by the states in which it was generated. The taxpayer has appealed an assessment by the State Comptroller that did not allow a credit against the county income tax portion of the Maryland income tax.

The Comptroller, as he should,[1] defends the tax law as written by the Legislature[2] and interpreted by this Court.[3] The taxpayers accept that interpretation, but assert that it is wanting when measured against the federal Constitution. They rely on a multitude of cases – virtually all of which are subsequent to the 1975 amendment of the Maryland tax law that uncoupled the credit from the county income tax – that assess state taxes against what has come to be known as the "dormant Commerce Clause."

Although the Maryland Tax Court ruled in favor of the Comptroller, the Circuit Court for Howard County reversed that decision and held that the statute's failure to allow such a credit violated the dormant Commerce Clause. For the reasons that follow, we find merit in the taxpayers' contentions and affirm the judgment of the Circuit Court.

Background

State Income Taxes

A state may tax the income of its residents, regardless of where that income is earned. A state may also tax a nonresident on income earned within the state. Both of these propositions are consistent with the

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[1] *See State v. Burning Tree Club, Inc.*, 301 Md. 9, 481 A.2d 785 (1984) (obligation of State official to defend constitutionality of statute enacted by General Assembly).

[2] *See* Chapter 3, Laws of Maryland 1975.

[3] *Comptroller v. Blanton*, 390 Md. 528, 890 A.2d 279 (2006).

Due Process Clause of the Fourteenth Amendment. *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S.450, 462-63 & n. 11 (1995); *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312-13 (1937). However, they raise the possibility of what might be termed "double taxation" when both the state of the taxpayer's residence and the state where the income was generated tax the same income. As explained below, the Commerce Clause of the federal Constitution sets certain constraints on this possibility, which the states recognize through the provision of credits for payments of out-of-state taxes.

Maryland Individual Income Tax

State law imposes an income tax on individuals. Maryland Code, Tax-General Article ("TG") §10-101 *et seq.*[4] It is composed of three parts:

> (1) a State income tax (the "State tax") at a rate set by the Legislature in statute, *see* TG §10-105;
>
> (2) a county income tax that applies only to residents of each county[5] (the "county tax") at a rate set by the county within the range allowed by statute, *see* TG §§10-103, 10-106; and

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[4] This law also imposes an income tax on corporations – which is not involved in the present case.

[5] As is usually the case, the term "county" in this context includes Baltimore City. TG §10-101(f).

> (3) a tax on those subject to State income tax but not the county tax (the "Special Non-Resident Tax" or "SNRT") at a rate equal to the lowest county tax, *see* TG §10-106.1.

Thus, all individual taxpayers are subject to the State tax and either the county tax or the SNRT. These taxes are all collected by the Comptroller; the proceeds of the county tax are distributed to the relevant county.

Credit for Income Taxes Paid to Other States

State law allows for an individual subject to the Maryland income tax to take a credit against the State tax for similar taxes paid to other states.[6] In particular:

> a resident may claim a credit only against the State income tax for a taxable year in the amount determined under [TG §10-703(c)] for State tax on income paid to another state for the year.

TG §10-703(a). There are various exceptions to this credit, none of which are pertinent to this case.[7] In

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[6] In this context, the term "state" includes "a state, possession, territory, or commonwealth of the United States ... or ... the District of Columbia." TG §10-101(u).

[7] The credit is not allowed to:

> (1) a Maryland resident other than a fiduciary, if the laws of the other state allow the Maryland resident a credit for state income tax paid in Maryland;

general, the credit is designed to ensure that Maryland receives, at a minimum, the Maryland income tax due on the taxpayer's income that is attributable to Maryland, regardless of the another state's method or rate of taxation.[8] *Comptroller v. Hickey*, 114 Md. App.

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(2) a Maryland resident fiduciary, if the fiduciary claims, and the other state allows, a credit for state income tax paid to Maryland;

(3) a Maryland resident for less than the full taxable year for tax on income that is paid to another state during residency in that state;

(4) a nonresident of Maryland.

TG §10-703(b).

[8] The statute provides that the credit shall be computed as follows:

(1) Except as provided in paragraph (2) of this subsection, the credit allowed a resident under subsection (a) of this section is the lesser of:

(i) the amount of allowable tax on income that the resident paid to another state; or

(ii) an amount that does not reduce the State income tax to an amount less than would be payable if the income subjected to the tax in the other state were disregarded.

(2) If the credit allowed a resident under subsection (a) of this section is based on tax that an S corporation pays to another state, the credit allowable to a shareholder:

(i) may not exceed that shareholder's pro rata share of the tax; and

388, 391, 689 A.2d 1316 (1997).

No credit is given against the county tax for income taxes paid in other states. TG §10-703(a); *Comptroller v. Blanton*, 390 Md. 528, 890 A. 2d 279 (2006). As this Court outlined in *Blanton*, a credit had previously applied with respect to the county tax. *See Stern v. Comptroller*, 271 Md. 310, 316 A.2d 240 (1974). However, in 1975, the Legislature amended the tax code to eliminate that credit. Chapter 3, Laws of Maryland 1975.[9]

S Corporations and Income Taxes

A Subchapter S corporation or "S corporation" is a corporation – often a relatively small business – that meets certain requirements set forth in the Internal Revenue Code and makes an election to pass through its income and losses, for federal tax purposes, to its shareholders.[10] Each shareholder reports his or her share of the S corporation's income and losses on their

---

(ii) will be allowed for another state's income taxes or taxes apsi based on income.

TG 10-703(c).

[9] The 1975 amendment was made to former Article 81, §290(b), which was later recodified as part of the Tax-General Article. Chapter 2, Laws of Maryland 1988. It has been re-enacted several times without substantive change. *See* Chapter 1, 1st Special Session, Laws of Maryland 1992; Chapter 262, Laws of Maryland 1993; Chapter 134, Laws of Maryland 1995.

[10] Douglas A. Kahn, et al., *Corporate Income Taxation* 220-21 (6th ed. 2009).

individual tax returns and is assessed federal income tax at the shareholder's individual rate. In that way, the income that the S corporation generates for its owners is taxed at one level – similar to the taxation of a partnership – rather than at two levels (corporate and shareholder) as is otherwise typically the case.[11] To accomplish this, the character of any item of income or loss of an S corporation "passes through" to its owners "as if that item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation." 26 U.S.C. §1366(b).

Some states accord similar pass-through treatment to the income of an S corporation; other states do not and require an S corporation to pay income tax directly. The Maryland income tax law incorporates, for the most part, the definitions of income under the Internal Revenue Code. *See* TG §§10-101(*l*), 10-107, 10-201 *et seq*. Accordingly, the income of an S corporation "passes through" and is attributed to its shareholders for purposes of the Maryland income tax law. *See* TG §10-104(6); *see also* TG §§10-102.1, 10-304(3).

The Wynnes and Maxim Healthcare Services

The underlying facts are undisputed. The taxpayers are Brian and Karen Wynne ("the Wynnes"), a married

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[11] The relevant statutory provisions appear in Subchapter S of Chapter 1 of the Internal Revenue Code – hence the moniker "S corporation." *See* 26 U.S.C. §1362(1). As is generally the case, the corporation is organized under the laws of a particular state; Subchapter S merely concerns its treatment for federal, and in some cases state, tax purposes.

couple with five children residing in Howard County. During the 2006 tax year, Brian Wynne was one of seven owners of Maxim Healthcare Services, Inc. ("Maxim"), a company that does a national business providing health care services, and owned 2.4% of its stock. Maxim had made an election under the Internal Revenue Code to be treated as an S corporation. As a result of that election, Maxim's income was "passed through" to its owners for federal income tax purposes, and the Wynnes reported a portion of the corporation's income on their individual federal income tax return.

Because Maryland accords similar pass-through treatment to the income of S corporations, the Wynnes also reported pass-through income of Maxim on their 2006 Maryland tax return. A substantial portion of the pass-through income had been generated in other states and was taxed by those states for the 2006 tax year.

In particular, for the 2006 tax year, Maxim filed state income tax returns in 39 states. Maxim allocated to each shareholder a pro rata share of taxes paid to the various states. The returns did not indicate payments of income taxes to any county or local entity in other states. The Wynnes claimed their pro rata share of such income taxes paid to other states as a credit pursuant to TG §10-703(c) against their 2006 Maryland individual income tax, reflected on Maryland Form 502.

Assessment and Appeal

The Comptroller made a change in the computation of the local tax owed by the Wynnes and revised the

credit for taxes paid to other states on the Wynnes' 2006 Maryland Form 502. The net result was a deficiency in the Maryland taxes paid by the Wynnes, and the Comptroller issued an assessment, which the Wynnes appealed.

On October 6, 2008, the Hearings and Appeals Section of the Comptroller's Office affirmed the assessment, although it revised it slightly.[12] The Wynnes then appealed to the Maryland Tax Court where they argued, for the first time, that the limitation of the credit to the State tax for tax payments made to other states discriminated against interstate commerce in violation of the Commerce Clause of the United States Constitution. The Tax Court rejected that argument and affirmed the assessment on December 29, 2009.

The Wynnes then sought judicial review in the Circuit Court for Howard County. Following a hearing

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[12] The Wynnes had originally submitted their return using the local tax rate for Carroll County and the Comptroller had later substituted the tax rate for Caroline County. The hearing officer concluded that the rate for Howard County should have been applied. There appears to be no dispute that the local tax should be computed using the rate for Howard County.

The Comptroller had determined that the Wynnes had incorrectly calculated the amount of the credit under an interpretation of TG §10-703(c) that was more favorable to themselves. The hearing officer upheld the Comptroller's revised computation, a decision that the Tax Court affirmed. The Wynnes did not further appeal that issue.

Neither of these issues is before us.

on the appeal, the Circuit Court reversed the Tax Court in a decision issued on June 29, 2011. The Circuit Court remanded the case to the Tax Court for further factual development and "an appropriate credit for out-of-state income taxes paid" on Maxim's income. An appeal was noted to the Court of Special Appeals on July 22, 2011. Prior to hearing and decision in the intermediate appellate court, this Court granted certiorari.

Discussion

Standard of Review

The Tax Court is "an adjudicatory administrative agency in the executive branch of state government."[13] A decision of the Tax Court is subject to the same standards of judicial review as contested cases of other administrative agencies under the State Administrative Procedure Act. TG §13-532(a)(1). In undertaking such review, this Court directly evaluates the decision of the agency[14] – in this case, the Tax Court.

When the Tax Court interprets Maryland tax law, we accord that agency a degree of deference as the agency that administers and interprets those statutes. *Comptroller v. Blanton*, 390 Md. at 533-35. In this case, the Tax Court's decision required the application and

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[13] *Furnitureland S., Inc. v. Comptroller*, 364 Md. 126, 137 n.8, 771 A.2d 1061, 1068 n.8 (2001); *see also* TG §3-102.

[14] *E.g., People's Counsel for Baltimore County v. Surina*, 400 Md. 662, 681, 929 A.2d 899, 910 (2007).

analysis of cases interpreting the United States Constitution. Because our review of its analysis turns on a question of constitutional law, we do not defer to the agency's determination. *Frey v. Comptroller*, 422 Md. 111, 138, 29 A.3d 475 (2011).

The Dormant Commerce Clause

The Wynnes do not contest the State's authority to tax their income, wherever earned, under the Due Process Clause. Rather, they base their challenge to the Comptroller's assessment on what has come to be known as the "dormant Commerce Clause" of the United States Constitution. *See, e.g., Quill Corp. v. North Dakota*, 504 U.S. 298, 313 n.7 (1992) ("[a] tax may be consistent with due process and yet unduly burden interstate commerce"). The dormant Commerce Clause is a restriction on State power that is not explicitly articulated in the Constitution but that has been derived as a necessary corollary of a power specifically conferred on Congress by the Constitution.

The Commerce Clause provides Congress with the power to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." United States Constitution, Article I, §8, cl. 3. "Though phrased as a grant of regulatory power to Congress, the [Commerce] Clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." *Oregon Waste Systems, Inc v. Department of Environmental Quality*, 511 U.S. 93, 98 (1994). This negative aspect of the Commerce Clause is an "implied limitation on the power of state and local governments to enact laws

affecting foreign or interstate commerce." *Board of Trustees v. City of Baltimore*, 317 Md. 72, 131, 562 A.2d 720, 749 (1989).

We assess first whether the dormant Commerce Clause is implicated by the county tax and, if so, whether the failure to provide a credit for out-of-state taxes violates the dormant Commerce Clause.

Does the Application of the County Tax without a Credit Implicate the Dormant Commerce Clause?

Although each of the three components of the State income tax has its own label and is created by different code provisions, each is for federal constitutional purposes a state income tax. *Frey*, 422 Md. at 141-42. In any event, whether the tax is nominally a state or county tax is irrelevant for purposes of analysis under the dormant Commerce Clause because a state may not unreasonably burden interstate commerce through its subdivisions any more than it may at the state level. *Associated Industries v. Lohman*, 511 U.S. 641, 650-51 (1994).

Much recent case law concerning the dormant Commerce Clause has been "driven by concern about economic protectionism — that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Dep't of Revenue v. Davis*, 553 U.S. 328, 337-38 (2008) (internal citation and quotation marks omitted). While many cases construing the dormant Commerce Clause concern state taxation, "[t]he dormant Commerce Clause protects markets and participants in markets, not taxpayers as such." *General Motors Corp. v. Tracy*, 519

U.S. 278, 300 (1997). Therefore, the dormant Commerce Clause will not affect the application of a tax unless there is actual or prospective competition between entities in an identifiable market and state action that either expressly discriminates against or places an undue burden on interstate commerce. *Id.* This impact must be more than incidental. *United States v. Lopez*, 514 U.S. 549, 559 (1995).

The Comptroller argues that the county income tax is not directed at interstate commerce and that the Wynnes have failed to identify any interstate commercial activity affected by a failure to allow a credit against that tax for tax payments to other states. However, application of the dormant Commerce Clause is not limited to circumstances where physical goods enter the stream of commerce. For example, a state tax exemption related to the movement of people across state borders for economic purposes has been held to implicate interstate commerce and violate the dormant Commerce Clause. *Camps Newfound/Owatonna v Town of Harrison*, 520 U.S. 564, 574 (1997); *see also Edwards v California*, 314 U.S. 160, 172 (1941) (state statute prohibiting transport of indigent persons into the state unconstitutional under Commerce Clause). Moreover, even when a state tax is imposed on an intrastate activity, if that tax substantially affects interstate commerce, the tax is subject to scrutiny under the Commerce Clause. *See, e.g., Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 332 (1977) (state securities transfer tax unconstitutional under dormant Commerce Clause to the extent it taxed in-state stock transfers resulting from out-of-state sales at a greater rate than in-state transfers resulting from in-state sales).

The Comptroller asserts that the Wynnes are subject to Maryland income taxes because of their status as Maryland residents and not because of their activities in intrastate or interstate commerce. But this is a false dichotomy. In fact, they are subject to the income tax because they are Maryland residents *and* because they have income derived from intrastate and interstate activities; other states may also tax some of that same income because it derives from activities in those state. This case concerns the constitutional constraint on the otherwise overlapping power to tax such income.

In making his argument based on a state's power to tax its own residents, the Comptroller relies on several cases from other states that fail to distinguish the constraints on state taxation imposed by the dormant Commerce Clause from those imposed by the Due Process Clause or that are otherwise distinguishable from the case. Those cases are not persuasive.[15]

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[15] For example, in *Keller v. Department of Revenue*, 872 P.2d 414 (Ore. 1994), an Oregon taxpayer sought a tax credit for taxes paid to the State of Washington under Washington's business and occupations tax. The Oregon Supreme Court declined to entertain the Commerce Clause challenge. In an opinion largely devoted to a determination that the Washington tax was an excise tax rather than an income tax, the Oregon court devoted only a single paragraph to the taxpayer's contentions that the failure to allow a credit in Oregon for the Washington tax contravened various federal constitutional provisions, including the Commerce Clause, and summarily rejected those arguments on the basis of several cases construing the Due Process Clause without acknowledging the separate constraint of the dormant Commerce Clause.

The limitation of the credit for payments of out-of-state income taxes to the State portion of the Maryland income tax can result in significantly different treatment for a Maryland resident taxpayer who earns substantial income from out-of-state activities when compared with an otherwise identical taxpayer who earns income entirely from Maryland activities. In particular, the first taxpayer may pay more in total state and local income taxes than the second. This creates a disincentive for the taxpayer – or the S corporation of which the taxpayer is an owner – to conduct income-generating activities in other states with income taxes. Thus, the operation of the credit with respect to the county tax may affect the interstate

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Tamagni v. Tax Appeals Tribunal, 695 N.E.2d 1125 (N.Y. 1998), *cert. denied*, 525 U.S. 931 (1998) concerned possible multiple taxation arising out of the fact that both New Jersey and New York classified the taxpayer as a resident, with the result that both states sought to tax investment income from intangible property, such as interest and dividends, and neither provided a credit for taxes paid to the other state with respect to that income. The New York Court of Appeals reasoned that, since the intangibles had no connection to any geographic location, there was no interstate market impacted by the tax, and thus the Commerce Clause was not implicated. *Id.* at 1130, 1134 Unlike *Tamagni*, the present controversy does not concern investment income from intangibles, but rather income attributed directly to the taxpayer and apportioned according to geographic ties.

See also Luther v. Commissioner of Revenue, 588 N.W.2d 502, 510-12 (Minn. 1999) (income tax on non-domiciliary resident did not risk multiple taxation due to credit); *Stelzner v. Commissioner of Revenue*, 621 N.W.2d 736, 741 (Minn. 2001) (income tax on non-domiciliary residents was consistent with due process and did not threaten multiple taxation as domiciliary state lacked an income tax).

market for capital and business investment and, accordingly, implicate the dormant Commerce Clause. *See, e.g,, Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (North Carolina property tax on intangibles that taxed investments in out-of-state businesses at a higher rate violated the Commerce Clause); *Boston Stock Exchange*, *supra*.

Does Application of the County Tax without a Credit Violate the Dormant Commerce Clause?

The Supreme Court has held that a state may tax interstate commerce without offending the dormant Commerce Clause so long as the tax satisfies a four-prong test. Under that test, a state tax survives a challenge under the dormant Commerce Clause if it:

> (1) applies to an activity with a substantial nexus with the taxing state;
>
> (2) is fairly apportioned;
>
> (3) is not discriminatory towards interstate or foreign commerce; and
>
> (4) is fairly related to the services provided by the State.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977); *see also D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30-31 (1988).

The Wynnes apparently do not dispute that the application of the county tax in this case has a substantial nexus to Maryland or that it is fairly

related to services provided by the State. Thus, for purposes of the present controversy, we focus on the remaining two prongs of the *Complete Auto* test: the requirement of fair apportionment and the prohibition against discrimination against interstate commerce.

(1) Is the county tax without a credit fairly apportioned?

The purpose of the apportionment requirement is to ensure that each state taxes only its fair share of an interstate transaction. *Goldberg v. Sweet*, 488 U.S. 252, 261 (1989). "It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause. In order to prevent multiple taxation of interstate commerce, the Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 446-47 (1979). "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile.... Otherwise there would be multiple taxation of interstate operations." *Standard Oil Co. v. Peck*, 342 U.S. 382, 384-85 (1952).

The dormant Commerce Clause does not mandate the adoption of a particular income allocation formula for apportionment. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) (states have "wide latitude" in the selection of an apportionment formula which will only be disturbed upon "clear and cogent evidence" that it leads to a "grossly distorted result"). In order to assess the fairness of apportionment courts look to whether a

tax is "internally consistent" as well as "externally consistent." *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 185 (1995).

(a) Is the county tax without a credit internally consistent?

"Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every state in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. at 185.

Internal consistency is thus measured by the answer to the following hypothetical question: If each state imposed a county tax without a credit in the context of a tax scheme identical to that of Maryland,[16] would interstate commerce be disadvantaged compared to intrastate commerce?

The answer is yes. In this scenario, TG §10-703 (or its hypothetical equivalent in other states) would grant

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[16] A state tax "must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme," and "proper analysis must take the whole scheme of taxation into account." *Maryland v. Louisiana*, 451 U.S. 725, 756 (1981); *Halliburton Oil Well Cementing Co. v. Reilly*, 373 U.S. 64, 69 (1963).

a credit against a taxpayer's home state income tax but not against the home county income tax for income taxes paid to other states. As a result, taxpayers who earn income from activities undertaken outside of their home states would be systematically taxed at higher rates relative to taxpayers who earn income entirely within their home state. Those higher rates would be the result of multiple states taxing the same income.

This is illustrated by the following example.

- *Tax rates*. Assume each state imposes a state tax of 4.75% on all the income of its residents, a county tax of 3.2% on all the income of residents, and a SNRT of 1.25% on the income of non-residents earned within the state.

- *Credit*. Assume that each state allows a credit for income taxes paid to other states that operates in the same fashion as TG §10-703 – *i.e.*, the formula for the credit and application of the credit take only the home state "state tax" into account.

- *Taxpayer with in-state income only*. Mary lives in Maryland and earns $100,000, entirely from activities in Maryland.

  Mary owes $4,750 in Maryland state income tax (.0475 x $100,000), $3,200 in Maryland county income tax (.032 x $100,000) for a total Maryland tax of **$7,950**.

- *Taxpayer with multi-state income*. John lives in Maryland and earns $100,000, half ($50,000) from

activities in Maryland and half ($50,000) from activities in Pennsylvania.

Because John is a resident of Maryland, all of his income is subject to both the Maryland "state tax" and the "county tax"applicable to his county. Before the application of any credit, John owes $4,750 in Maryland state income tax (.0475 x $100,000), $3,200 in Maryland county income tax (.032 x $100,000) for a total Maryland tax of $7,950.

Because half of John's income was generated in Pennsylvania, John also owes $2,375 in Pennsylvania state income tax (.0475 x $50,000) and $625 with respect to the Pennsylvania SNRT (.0125 x $50,000) for a total Pennsylvania tax of $3,000.

John receives a credit in the amount of $2,375 with respect to his Maryland state income tax pursuant to credit formula set forth in TG §10-703(c).[17] This

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[17] Under TG §10-703(c), the credit is computed as *the lesser of*:

(1) "the amount of allowable tax on income paid to the other state – in this example, $3000, if we assume that the credit encompasses both the Pennsylvania state income tax and the Pennsylvania SNRT.

and

(2) "an amount that does not reduce the [Maryland] state income tax to an amount less than would be payable if the income subjected to tax in the other state were disregarded."

reduces his Maryland income tax to $5,575.

> Thus, John owes a combined total of **$8,575** in state income taxes.

As the above example demonstrates, a taxpayer with income sourced in more than one state will consistently owe more in combined state income taxes than a taxpayer with the same income sourced in just the taxpayer's home state. This may discourage Maryland residents from engaging in income-earning activity that touches other states. In the context of S corporations, it may encourage Maryland residents to invest in purely local businesses, and discourage businesses from seeking to operate both in Maryland and in other states. In effect, it acts as an extra tax on

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The following calculation determines the figure for second provision of the above formula: If the income subjected to tax in Pennsylvania in this example were disregarded, the Maryland state income tax would be $2,375 (.0475 x $50,000). Thus, under this provision, the credit is capped at $2,375 – the difference between John's Maryland state tax liability ($4,750, as computed in the text) and the amount of Maryland state tax he would pay if his Pennsylvania income were ignored ($2,375).

Thus, the first method of figuring the credit yields $3,000 and the second method yields $2,375. Because the maximum allowable credit is the *lesser* of the two amounts, John would receive a credit in the amount of $2,375.

The parties disputed whether the SNRT would be included in the credit computation and whether doing so would change the result of this example. However, the same result obtains whether or not the Pennsylvania SNRT, as well as the Pennsylvania state tax, is included in the credit computation.

interstate income-earning activities. It fails the internal consistency test.[18]

While it is true that a failure to pass the internal consistency test does not always signal a constitutional defect in a state tax scheme, the circumstances under which the courts have tolerated a lack of internal consistency do not pertain here. One such case concerned a flat $100 annual fee imposed by Michigan upon trucks engaged in intrastate commercial hauling. *American Trucking Assns., Inc. v. Michigan Pub. Serv. Comm'n,* 545 U.S. 429 (2005). The petitioners in that case challenged the fee on the ground that it discriminated against interstate carriers and unconstitutionally burdened interstate trade because the fee was flat but trucks carrying both interstate and intrastate loads engaged in less intrastate business than trucks carrying only intrastate loads. 545 U.S. at 431-32. The Supreme Court held that the fee did not violate the dormant Commerce Clause. In analyzing the internal consistency of the tax, the Court concluded that, if every state imposed such a fee, an interstate trucker doing local business in multiple states would

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[18] Some state courts have concluded that a tax that fails the internal consistency test is unconstitutional under the dormant Commerce Clause. *See Northwest Energetic Services, LLC v. California Franchise Tax Board*, 71 Cal. Rptr. 3rd 642, 658 (Cal. App. 1st Dist. 2008) (holding unconstitutional an unapportioned local tax to the extent that it applied to out-of-state business income); *M & Assocs, Inc.. v. City of Irondale*, 723 So. 2d 592, 598-99 (Ala. 1998) (local franchise tax based on total gross receipts regardless of whether goods were sold in-state or out-of-state would result in state taking more than its fair share of taxes from interstate transaction).

have to pay hundreds or thousands of dollars in fees if it supplemented its interstate business by carrying local loads in many other states, thus an internal inconsistency. The Court nonetheless found no Commerce Clause violation because a business would have to incur such fees only because it engaged in local business in all those states. *Id.* at 438. "An interstate firm with local outlets normally expects to pay local fees that are uniformly assessed upon all those who engage in local business, interstate and domestic firms alike." *Id.* Such a fee, in effect a toll on in-state activity, is factually distinguishable from the present case involving business performed and income earned outside of Maryland. Moreover, we are not aware of an instance in which a court has upheld an unapportioned *income* tax on the authority of *American Trucking*.

The Comptroller advances an alternative argument. Because an individual can only be a resident of one county in the universe,[19] even if every taxing jurisdiction adopted Maryland's tax structure, the individual would only be required to pay a county tax once. This, argues the Comptroller, precludes the possibility of multiple taxation by operation of the county tax. However, this analysis appears to be inconsistent with the logic underlying this Court's

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[19] The county tax applies to a resident of a county if, on the last day of the taxable year, the person was domiciled in the county or maintained a principal residence or place of abode there. TG §10-103(a). We assume, without deciding, that a person can be a resident of only one county under the statute. This may not be a safe assumption as the definition appears to allow for a principal place of abode that is different from the place of domicile, but it is fundamental to the Comptroller's argument.

holding in *Frey* that the Maryland SNRT is a state tax for constitutional purposes. 422 Md. at 142. Moreover, under dormant Commerce Clause analysis, there are generally only two levels of regulation, state and federal. *See Associated Indus. v. Lohman*, 511 U.S. 641, 650-51 (1994). The Comptroller's analysis posits a third level, the local level, such that a local tax need only be considered in the light of local taxes in other jurisdictions. But there appears to be no authority in the case law for this position.[20]

(b) Is the county tax without a credit externally consistent?

The next question is whether the current county tax scheme is externally consistent.[21] For this test, one

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[20] As this Court discussed in *Frey*, the SNRT is justified as a "compensatory" tax on non-residents that is analogous to the county tax and that is imposed at a rate equivalent to the county tax in at least one Maryland county. 422 Md. at 149-63. Accordingly, even if one is a resident of a county of the universe other than Maryland, one may be subject to a Maryland tax analogous to the county tax – a fact that undermines the Comptroller's theory that the county tax should be considered separately from state taxation for purposes of the Commerce Clause. Even if Commerce Clause analysis recognized a third layer of income taxation, the existence of the SNRT shows how vulnerable that layer would be to multiple taxation.

[21] Although the external consistency test is only applied to confirm the proper apportionment of a tax already found to be internally consistent, *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 185 (1995), it seems prudent to address this issue given the possibility that dormant Commerce Clause jurisprudence will continue to develop in the wake of *American Trucking Assns., Inc. v. Michigan Pub. Serv. Comm'n*, 545 U.S. 429 (2005).

must assess "whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg v. Sweet*, 288 U.S. 252, 262 (1989). This test looks to a state's "economic justification" for its claim on the value taxed "to discover whether a state's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing state." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). "[T]he threat of real multiple taxation (though not by literally identical statutes) may indicate a state's impermissible overreaching." *Id.*

Thus, to test for external consistency one asks: Does tax liability under the Maryland income tax code reasonably reflect how income is generated? Because no credit is given with respect to the county tax for income earned out-of-state, the Maryland tax code does not apportion income subject to that tax even when that income is derived entirely from out-of-state sources. Thus, when income sourced to out-of-state activities is subject to the county tax, there is a potential for multiple taxation of the same income. In those circumstances, the operation of the county tax appears to create external inconsistency.[22] This is

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[22] In discussing the external consistency test, the Comptroller argues that the county tax has no effect on interstate activity on the basis that the Wynnes themselves did not directly participate in interstate commerce and the income in question is investment income. The Wynnes respond that Mr. Wynne was an officer of the company and therefore involved in its interstate activities though it is not readily apparent how that is relevant as the issue before us does not concern his salary. More to the point is that the income

further indication that the application of the tax in these circumstances without application of an appropriate credit violates the dormant Commerce Clause.[23]

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in question is "pass-through" income of an S corporation that was generated outside of Maryland. Under the Internal Revenue Code and the Maryland tax code, such income is attributed to shareholders like the Wynnes "as if [it] were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation." 26 U.S.C. §1366(b); TG §10-107.

It is this treatment of pass-through income of S corporations that allows Maryland to tax non-resident individuals with no other connection to Maryland who have pass-through S corporation income from activities in Maryland. *See* TG §10-401. Thus, the same provisions that form the basis for Maryland to tax such income also govern the characterization of such income. Such income is not necessarily or simply to be characterized as investment income.

[23] Courts in other states have found local taxes that lack external consistency to be unconstitutional. *See Phila. Eagles Football Club, Inc. v. City of Philadelphia*, 823 A.2d 108, 131-35 (Pa. 2003) (levy on 100 percent of media receipts where half the team's games were broadcast from locations outside the taxing jurisdiction held to be externally inconsistent even though tax passed internal consistency test); *City of Winchester v. American Woodmark Corp.*, 471 S.E.2d 495, 498 (Va. 1996) (although business license tax had been held to be internally consistent, levy on 100 percent of revenues of locally headquartered company held to be externally inconsistent where the income was derived in part from sales and manufacture located outside taxing jurisdiction and the tax bore no relationship to income generated in the jurisdiction); *Avanade, Inc. v. City of Seattle*, 211 P.3d 476, 482-83 (Wash. Ct. App. 2009) (apportionment formula that allocated all revenues to headquarters city when substantial revenues were derived in other states found to be externally inconsistent).

(2) Does the County Tax Discriminate against Interstate Commerce?

Under the third prong of the *Complete Auto* test, a tax must not discriminate against interstate commerce. Even if a tax is fairly apportioned, it "may violate the Commerce Clause if it is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce." *Amerada Hess Corp. v. Director, Div. of Taxation, New Jersey Dep't of Treasury*, 490 U.S. 66, 75 (1989). A state tax may not discriminate against a transaction because the transaction has an interstate element or because the transaction or incident crosses state lines. *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984). A taxing scheme that encourages interstate businesses to conduct more of their business activities within the taxing state may be found to be discriminatory. *Amerada Hess Corp.*, 490 U.S. at 77-78. Facially discriminatory state taxes are subject to the strictest scrutiny, and the "burden of justification is so heavy that 'facial discrimination by itself may be a fatal defect.'" *Oregon Waste Systems, Inc.*, 511 U.S. at 101 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 337 (1979)). There is no "*de minimis*"

A tax that risks multiple taxation but that survives external consistency scrutiny is the sales tax. *See Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 191 (1995). Similarly, taxes on services such as telephone calls have been upheld. *See Goldberg v. Sweet*, 488 U.S. 252 (1989). The Court has permitted these taxes by noting that a tax on a buyer is different from a tax on a seller. *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. at 190. In this case, however, the Wynnes are sellers because their income is generated through the sale of a good or service, whereas a tax on a buyer is a tax on consumption.

justification if a tax is found to actually discriminate against interstate commerce. *Fulton Corp. v. Faulkner*, 516 U.S. 325, 332 n.3 (1996). Discriminatory effect may lie in the tax itself, but it may also arise from interactions with other states' taxes. *See, e.g., Barringer v. Griffes*, 1 F.3d 1331, 1337-39 (2d Cir. 1993) (state use tax on automobiles that provided credit for sales tax paid in-state, but not out-of-state was discriminatory).

Particularly pertinent to the present case is the Supreme Court's analysis of a North Carolina tax in *Fulton Corp. v. Faulkner*, *supra*. North Carolina imposed an "intangibles tax" on the value of corporate stock owned by North Carolina residents. The tax was computed as a fraction of the value of the stock, with the tax rate reduced to the extent that the corporation's income was subject to tax in North Carolina. 516 U.S. at 327-28. This resulted in a North Carolina stockholder being taxed at a higher rate for holdings in companies that did not do business in North Carolina and at lower rates for holdings in companies that did business in North Carolina. The Supreme Court held that the tax violated the dormant Commerce Clause because it discriminated against interstate commerce. *Id.* at 333, 344.[24] In striking down the tax, the Court stated: "[A] regime that taxes stock only to the degree

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[24] The Court also held that the discriminatory aspect of the tax could not be justified as a valid "compensatory" tax – *i.e.*, a tax on interstate commerce that complements a tax on intrastate commerce to the extent that it "compensates" for the burdens imposed on intrastate commerce by imposing a similar burden on interstate commerce. 516 U.S. at 331 n.2, 334-44. *See* note 25 below.

that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents...." *Id.* at 333.

This case presents a similar situation. The application of the county tax to the out-of-state pass-through income without application of a credit for out-of-state income taxes on the same income means that Maryland shareholders – the Wynnes in this case – may be taxed at a higher rate on income earned through Maxim's out-of-state activities than on income earned though its Maryland activities. This would appear to favor businesses that do business primarily in Maryland over their competitors who do business primarily out-of-state – at least in the context of ownership of a Subchapter S corporation. The only difference between *Fulton* and the present case is one of form. Whereas in *Fulton* it was North Carolina's own tax rate that varied, in the present case it is the imposition of an additional tax, the tax set by the state where the income was earned – and the failure to provide a credit for it in Maryland – that creates the discrimination. Nonetheless, the effect is the same.

While the failure to allow a credit is at the heart of the discrimination in this case, not every denial of a deduction or credit for taxes paid to another jurisdiction results in a violation of the dormant Commerce Clause. In *Amerada Hess v. New Jersey Dept. of the Treasury,* the Supreme Court evaluated the constitutionality of a New Jersey statute that denied to oil-producing companies a deduction for amounts paid under the federal windfall profits tax. Holding that the tax did not violate the Commerce Clause, the Court

noted, "a deduction denial does not unduly burden interstate commerce just because the deduction denied relates to an economic activity performed outside the taxing State." 490 U.S. at 78 n.10.

Amerada Hess is distinguishable from the present case however. At issue in *Amerada Hess* was a state deduction for a federal income tax – a tax that a business would be subject to no matter where it was located in the United States, whether within New Jersey or elsewhere. By denying a tax credit in that case, New Jersey treated all similarly-situated taxpayers equally because a business was subject to the same rate regardless of whether the windfall profits were earned within New Jersey or elsewhere. By contrast, the failure to provide a credit against the county tax in this case penalizes investment in a Maryland entity that earns income out-of-state: an investment in such a venture incurs both out-of-state taxes and the Maryland county tax on the same income; a similar venture that does all its business in Maryland incurs only the county tax.

The tax at issue in this case is also similar to the one in *Halliburton Oil Well Co. v. Reily*, 373 U.S. 64, 72 (1963). There, a Louisiana statute had the discriminatory effect of imposing a greater tax on goods manufactured outside Louisiana than on goods manufactured within that state, thereby creating an incentive to locate the manufacturing process within Louisiana. Although the mechanism is different, the application of the credit in Maryland's income tax law has a similar discriminatory effect. The more a Maryland business can locate its value-creating activities within Maryland the less it will be taxed. *See*

also Camps Newfound / Owatonna v. Town of Harrison, 520 U.S. 564 (1997) (application of tax exemption that disfavored in-state businesses with out-of-state clientele violated dormant Commerce Clause).

Thus, the application of the county tax to pass-through S corporation income sourced in other states that tax that income, without application of an appropriate credit, discriminates against interstate commerce.[25]

Conclusion

For the reasons explained above, the failure of the Maryland income tax law to allow a credit against the county tax for a Maryland resident taxpayer with respect to pass-through income of an S corporation that arises from activities in another state and that is taxed in that state violates the dormant Commerce Clause of the federal Constitution.[26]

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[25] Such a discriminatory tax may survive constitutional scrutiny if the tax is a "compensatory" tax. *See Oregon Waste Systems,* 511 U.S. at 102-3; *see also Frey*, 422 Md. at 145-63 (analyzing whether Maryland SNRT is a compensatory tax). The Comptroller has not argued that failure to allow a credit against the county tax with respect to payments of out-of-state income taxes is part of a compensatory tax. *See Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (rejecting argument that North Carolina's discriminatory "intangibles" tax was a compensatory tax based on inability of state to collect corporate income tax from out-of-state corporations).

[26] Our colleague, Judge Greene, offers a thoughtful dissent to this conclusion. While we are not unsympathetic to the dissent as a matter of policy, we find its legal analysis unpersuasive.

The dissent first points to a hypothetical situation – not this case – in which the application of the credit for out-of-state tax payments with respect to income earned in another state with a higher tax rate than Maryland could lead to the "absurd result" that a county resident who earned all of his or her income in the other state with the higher income tax rate would pay little or no county income tax on that same income while a neighbor who earned a similar income from activity solely within Maryland and is taxed only in Maryland would pay county income tax. This rhetorical statement proves both too much and too little.

It proves too much because, in the situation posited by the dissent, the credit for the higher out-of-state tax payments would have a similar effect on the taxpayer's state income tax liability. But the dissent does not assert, and could not credibly suggest, that the state income tax would survive a challenge under the Commerce Clause without a credit for out-of-state tax payments made with respect to out-of-state income. It proves too little because the application of the credit has no effect on the taxpayer's liability for sales taxes, local property taxes, and other taxes unrelated to income that are used to provide state and county services.

The dissent also argues that key Supreme Court decisions on the application of the dormant Commerce Clause to state taxes are distinguishable on the basis that the taxes at issue in those cases were "facially discriminatory" in a way that the county tax in this case is not. But this is more a matter of semantics than substance. For example, in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), the North Carolina law in question allowed a deduction from the state intangibles tax for corporate income taxes paid in North Carolina, but no deduction for entities that were not subject to the state income tax (*i.e.*, entities that did business elsewhere) – thus effectively favoring intra-state commerce over interstate commerce. The failure to allow a credit in this case for out-of-state tax payments has the same effect as withholding a deduction in *Faulkner*. In the end, it is perhaps most telling that the dissent does not attempt to analyze the application of the county income

As for relief, the Wynnes suggest in their brief that the Maryland county income tax, the credit, or some part of the Maryland tax scheme be "struck down." In fact, the county income tax itself is not unconstitutional. Nor is the credit, which serves to ensure that the Maryland income tax scheme operates within constitutional constraints. Nor is the Maryland income tax law generally. What is unconstitutional is the application – or lack thereof – of the credit to the county income tax. As this Court explained in some detail in *Blanton,* a credit previously applied to the county income tax in these circumstances. The county income tax was only eliminated from the computation and application of the credit by a 1975 amendment of the tax code. Chapter 3, Laws of Maryland 1975. It is that amendment, when applied to the particular circumstances of taxpayers like the Wynnes, that contravenes the Constitution.[27] On remand from the Circuit Court, the Tax Court should recalculate the Wynnes' tax liability in a manner consistent with this opinion.

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tax without a credit under the *Complete Auto* test – the analysis that the Supreme Court has directed courts to apply in assessing State taxes under the Commerce Clause.

[27] Other provisions of the 1975 amendment and the later re-enactments are severable. *See Muskin v. State Department of Assessments and Taxation,* 422 Md. 544, 554 n.5, 30 A.3d 962 (2011) ("there is a strong presumption that if a portion of an enactment is found to be invalid, the intent is that such portion be severed").

JUDGMENT OF THE CIRCUIT COURT FOR HOWARD COUNTY AFFIRMED WITH DIRECTION TO REMAND TO THE TAX COURT FOR FURTHER PROCEEDINGS CONSISTENT WITH THIS OPINION. COSTS TO BE SHARED EQUALLY BY THE PARTIES.

IN THE COURT OF APPEALS OF MARYLAND

No. 107

September Term, 2011

[Filed January 28, 2013]

MARYLAND STATE COMPTROLLER OF THE TREASURY	)
	)
V.	)
	)
BRIAN WYNNE, et ux.	)

Bell, C.J.
Harrell
Battaglia
Greene
Adkins
Barbera
McDonald,

JJ.

Dissenting Opinion by Greene, J.,
which Battaglia, J., Joins.

I disagree with the Majority's conclusion that the federal Constitution's dormant Commerce Clause requires Maryland to reduce the Wynnes' county taxes. Since the early Nineteenth Century, the law has been:

> [T]he power of taxation is one of vital importance . . . retained by the states. . . . [T]he power of taxing the people and their property[] is essential to the very existence of government, and may be legitimately exercised on the objects to which it is applicable, to the utmost extent to which the government may choose to carry it. The only security against the abuse of this power, is found in the structure of the government itself. In imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation.

McCulloch v. Maryland, 17 U.S. 316, 4 Wheat. 316, 425, 428, 4 L. Ed. 579, 606, 607 (1819). The Wynnes may not agree that they should pay the Howard County tax without a credit pursuant to TG § 10-703. This, however, is an issue for the elected officials of Howard County and the State, not this Court. "It is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Goldberg v. Sweet*, 488 U.S. 252, 266, 109 S. Ct. 582, 591, 102 L. Ed. 2d 607, 620 (1989) (noting additionally that the dormant Commerce Clause is not designed to protect the "insider who presumably is able to complain about and change the tax through the [state] political process"). The Maryland General Assembly's decision to apply a credit for taxes paid in other states to the Wynnes' state tax, and not their county tax, does not run afoul of the federal Constitution's dormant Commerce Clause.

The Wynnes live in Howard County where they benefit from the services provided by that county. *See*

Frey v. Comptroller, 422 Md. 111, 150, 29 A.3d 475, 497-98 (2011). To pay for these services, Howard County, like every county in Maryland, including Baltimore City, assesses a tax. As the Majority notes, TG § 10-703 does not permit the Wynnes to apply a credit for taxes paid in other states to reduce the Howard County tax. *Comptroller v. Wynne*, __ Md. __, __, __ A.3d __, __ (2013) (Maj. Slip Op. at 5). Rather, as we said in *Comptroller v. Blanton*, 390 Md. 528, 535, 543, 890 A.2d 279, 283, 288 (2006), residents of a Maryland county are required to pay for that county's services by paying the county tax without the credit. Otherwise, "if the taxpayers were allowed to pay a lesser amount of county income tax, it 'would have the possible absurd result of the [taxpayers] paying little or no local tax for services provided by the county while a neighbor with similar income, exemptions, and deductions might be paying a substantial local tax to support those services.'" *Blanton*, 390 Md. at 536 n. 9, 890 A.2d at 284 n. 9 (quoting *Coerper v. Comptroller*, 265 Md. 3, 8, 288 A.2d 187, 189 (1972)).

The Majority acknowledges that Maryland law prohibits the Wynnes from applying a credit for taxes paid to other states to reduce their county taxes. *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 5). The Majority, however, concludes that imposing a county tax without allowing for a credit pursuant to TG § 10-703 violates the dormant Commerce Clause because Maryland's taxing scheme fails two prongs of the *Complete Auto* four-part test, namely that it is not fairly apportioned, and it discriminates against interstate commerce. *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 17, 20, 23-24, 28-29). As we have said before, however:

> Declaring a statute enacted by the General Assembly to be unconstitutional and therefore unenforceable is an extraordinary act. Statutes are generally presumed to be Constitutional and are not to be held otherwise unless the Constitutional impediment is clear. We have said many times that since every presumption favors the validity of a statute, it cannot be stricken down as void, unless it plainly contravenes a provision of the Constitution.

Maryland State Bd. of Ed. v. Bradford, 387 Md. 353, 387, 875 A.2d 703, 723 (2005) (quotation and citations omitted). *See also San Antonio Independent Sch. Dist. v. Rodriguez*, 411 U.S. 1, 44, 93 S Ct. 1278, 1302, 36 L. Ed. 2d 16, 49 (1973) (noting that state laws are traditionally accorded a "presumption of constitutionality"). Because of this presumption, a heavy burden is on the Wynnes to prove that this Court should not enforce Maryland law as it is written.

The Majority states that before this Court can decide whether the dormant Commerce Clause has been violated, we must "assess first whether the dormant Commerce Clause is implicated by the county tax . . . ." *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 11). Contrary to the Majority's conclusion, however, it appears that the Wynnes have failed to meet their burden of showing that the dormant Commerce Clause is implicated.[1]

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[1] In *General Motors v. Tracy*, 519 U.S. 278, 300, 117 S. Ct. 811, 825, 136 L. Ed. 2d 761, 781 (1997), the Supreme Court noted that "in the absence of actual or prospective competition" within "a

States have the power to impose taxes that may result in some overlap in taxation of income. *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-79, 98 S. Ct. 2340, 2346-47, 57 L. Ed. 2d. 197, 207-08 (1978) (concluding that it does not necessarily constitute a violation of the dormant Commerce Clause when two states' taxing schemes tax income differently, and this results in some overlap in taxation). As the Majority notes, "[T]he dormant Commerce Clause will not affect the application of a tax unless there is actual or perspective competition between entities in an identifiable market and state action that either expressly discriminates against or places an undue burden on interstate commerce. [*General Motors Corp. v. Tracy*, 519 U.S. 278, 300, 117 S. Ct. 811, 825, 136 L. Ed. 2d 761, 781 (1997)]. This impact must be more than incidental. *United States v. Lopez*, 514 U.S. 549, 559

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single market" between those engaged in interstate commerce and those engaged in intrastate commerce, there can be no dormant Commerce Clause violation. Because of this, the New York Court of Appeals has determined that before a tax can be subjected to the *Complete Auto* test, the party challenging the tax must "identify the interstate market that is being subjected to discriminatory or unduly burdensome taxation." *In re Tamagni*, 695 N.E.2d 1125,1131 (NY 1998). "This requires, at the outset, identification of the similarly situated in-State and out-of-State interests which the tax treats differently." *Id.* The Wynnes argue that "Maryland taxpayers and companies that do business out of state, on the one hand, and those that restrict their trade to Maryland, on the other" constitute similarly situated parties in one market. These two groups are not similarly situated, however. Those who engage in out-of-state business enjoy the protections and markets provided by the states where they do business. Taxpayers and companies that restrict their business to Maryland only receive the protections and services provided by Maryland.

[115 S. Ct. 1624, 1630, 131 L. Ed. 2d 626, 637] (1995)." *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 12). In the present case, the Wynnes have failed to prove that requiring them to pay a county tax without a credit either expressly discriminates against interstate commerce or places more than an incidental burden upon interstate commerce. Therefore, the Wynnes have failed to prove that the dormant Commerce Clause is implicated.

The Howard County tax, assessed without a credit, does not expressly discriminate against interstate commerce. As the Comptroller argues, the Howard County tax is directed at income earned by residents of Howard County, not interstate commerce.[2] And while, as the Majority notes, the dormant Commerce Clause

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[2] In most of the cases where the Supreme Court has subjected a tax to the *Complete Auto* test, the tax was directly on interstate commerce itself or items in interstate commerce. *See Okla. Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 177, 183, 115 S. Ct. 1331, 1334, 1337, 131 L. Ed. 2d 261, 267, 271 (1995) (analyzing an Oklahoma tax on a bus ticket for interstate travel); *Goldberg*, 488 U.S. at 255-56, 259-60, 109 S. Ct. at 585-86, 587-88, 102 L. Ed. 2d at 613, 615-16 (analyzing an Illinois state tax on interstate calls); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 26, 31-33, 108 S. Ct. 1619, 1620-21, 1623-24, 100 L. Ed. 2d 21, 24, 28-29 (1988) (analyzing a Louisiana use tax on catalogs printed outside the state and shipped to persons in the state); *Wardair Canada v. Fla. Dept. of Revenue*, 477 U.S. 1, 3-4, 8, 106 S. Ct. 2369, 2370-71, 2373, 91 L. Ed. 2d 1, 7, 10 (1986) (analyzing a tax on fuel sold in Florida and used in interstate commerce). The challenged Howard County tax without a credit is assessed upon the income of residents of the County. While a portion of that income may derive from interstate commerce, the challenged tax is not directed to interstate commerce or items in interstate commerce. Rather, the connection to interstate commerce is more attenuated.

"is not limited to circumstances where physical goods enter the stream of commerce[,]" *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 12), the other cases the Majority relies on all involve situations where, unlike the present case, the law was facially discriminatory. The Majority looks to *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564, 117 S. Ct. 1590, 137 L. Ed. 2d 852 (1997), *Edwards v. California*, 314 U.S. 160, 62 S. Ct. 164, 86 L. Ed. 119 (1941), *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 97 S. Ct. 599, 50 L. Ed. 2d 514 (1977), and *Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S. Ct. 848, 133 L. Ed. 2d 796 (1996) to conclude that the dormant Commerce Clause is implicated. In all four of those cases, the challenged tax law facially discriminated against interstate commerce by either first distinguishing between organizations and businesses that were involved in interstate business and those organizations and businesses that were only involved with intrastate business, and then imposing a disadvantage upon those involved in interstate transactions, or, in the case of *Edwards*, placing a restriction upon people moving in interstate commerce itself.

In *Camps Newfound/Owatonna*, the challenged Maine tax law granted a general exemption from real estate and personal property taxes for charities incorporated in Maine, but limited that exemption for organizations that mostly served non-Maine residents. 520 U.S. at 568, 117 S. Ct. at 1594, 137 L. Ed. 2d at 859. The law, thereby, distinguished between groups that served people traveling in interstate commerce and those that only served Maine residents and explicitly benefitted the latter. 520 U.S. at 575-76, 117 S. Ct. at 1598, 137 L. Ed. 2d at 864. In *Edwards*, the

challenged law directly implicated interstate commerce and travel by prohibiting the transportation of indigent persons across state lines. 314 U.S. at 174, 62 S. Ct. at 167, 86 L. Ed. at 125-26. In *Boston Stock Exchange*, the challenged New York tax law distinguished between sales of securities made within New York and those made outside New York, and then imposed a lower tax rate and a cap on taxes for in-state sales and a higher tax rate and no cap on taxes for out-of-state sales. 429 U.S. at 319, 324-25, 97 S. Ct. at 602, 604, 50 L. Ed. 2d at 518, 521. Finally, in *Fulton Corp.*, North Carolina imposed a tax on investments in corporations but allowed stockholders to reduce their tax liability based on the business the corporation did in North Carolina. 516 U.S. at 327-328, 116 S. Ct. at 852, 133 L. Ed. 2d at 802-03. In *Fulton Corp.*, the United States Supreme Court noted that the tax facially discriminated against interstate commerce, and North Carolina "practically concede[d] as much." 516 U.S. at 333, 116 S. Ct. at 855, 133 L. Ed. 2d at 806.

In the present case, nothing on the face of the Maryland tax laws imposing a county tax, TG § 10-103, or the Maryland tax law limiting credits for taxes paid in other states to state taxes, TG § 10-703, discriminates against interstate commerce. TG § 10-103 imposes a county tax on all residents with no distinction drawn based upon the source of the income. And, TG § 10-703, on its face, provides a benefit to interstate commerce by applying a credit to reduce the amount of Maryland state taxes paid by residents who earned income in interstate commerce. The only distinction drawn between income earned in intrastate commerce and income earned in interstate commerce pursuant to these two laws is that a benefit

is bestowed upon interstate commerce through the credit that is applied to state taxes. This can hardly be interpreted as discriminating against interstate commerce on the face of the law.

The fact that Maryland's tax scheme is not facially discriminatory is critical to the dormant Commerce Clause analysis. As the Majority notes, "[f]acially discriminatory state taxes are subject to the strictest scrutiny, and the 'burden of justification is so heavy that 'facial discrimination by itself may be a fatal defect.'" *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 25) (quoting *Oregon Waste Systems, Inc. v. Dept. of Envtl. Quality*, 511 U.S. 93, 101, 114 S. Ct. 1345, 1351, 128 L. Ed. 2d 13, 22 (1994) (in turn quoting *Hughes v. Oklahoma*, 441 U.S. 322, 337, 99 S. Ct. 1727, 1737, 60 L. Ed. 2d 250, 262 (1979)); *see also Frey*, 422 Md. at 144, 29 A.3d at 494 ("[F]acially discriminatory state taxes raise a presumption of per se invalidity."). In other words, when a court is examining a law that, on its face, draws a distinction between interstate and intrastate commerce and imposes a disadvantage to the former, the burden of proving that the law expressly discriminates against interstate commerce and that the dormant Commerce Clause is implicated is met. *See United Haulers Ass'n. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338-39, 127 S. Ct. 1786, 1793, 167 L. Ed. 2d 655, 664-65 (2007). In this case, there is no facial discrimination against interstate commerce, and thus, the burden of proving that the dormant Commerce Clause is implicated requires a higher level of proof.

As noted above, the Wynnes have the burden of proving that interstate commerce is implicated. The

Wynnes, however, fail to meet this burden with the arguments they present. In arguing that the dormant Commerce Clause is implicated, the Wynnes primarily rely on two lines of arguments, both of which are inapplicable to the present case.

First, the Wynnes rely on our decision in *Frey* where we concluded that the "Special Nonresident Tax," or SNRT, implicated the dormant Commerce Clause.[3] The SNRT is applied to nonresidents doing business in Maryland. On its face, the SNRT singles out income from interstate commerce and applies a tax on that income. It is thus a "facially discriminatory state tax[]," and subject to "the strictest scrutiny[.]" *Frey*, 422 Md. at 144, 29 A.3d at 494. The county tax, on the other hand, draws no distinction between income earned in interstate and intrastate commerce and is not facially discriminatory. Therefore, unlike the SNRT, the county tax does not expressly discriminate against interstate commerce and our conclusion in *Frey* that the SNRT implicated the dormant Commerce Clause is inapplicable to the present case.

Second, the Wynnes rely on *Camps Newfound/Owatonna*, *Fulton Corp.*, and a case from the Minnesota Supreme Court, *Chapman v. Comm'r of*

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[3] Similarly, at oral argument before this Court, counsel for the Wynnes argued that, in footnote 14 of the *Frey* decision, this Court indicated that the county tax implicates the dormant Commerce Clause. A close reading of footnote 14 indicates that what we concluded was that "[t]he SNRT may thereby substantially affect interstate commerce and is consequently susceptible to Commerce Clause scrutiny." 422 Md. at 143 n. 14, 29 A.3d at 493 n. 14. We said nothing in the footnote about county taxes.

Revenue, 651 N.W. 2d 825 (Minn. 2002). As noted above, *Camps Newfound/Owatonna* and *Fulton Corp.* address facially discriminatory laws. Likewise, *Chapman* addresses a facially discriminatory law. The law in question allowed Minnesota taxpayers to take a tax deduction for contributions to charities "located in and carrying on substantially all of its activities within [Minnesota]," but did not allow a tax deduction for contributions to non-Minnesota charities. 651 N.W. 2d at 834. The Minnesota Supreme Court stated that "[o]n its face, the statute treats contributions to in-state charitable organizations differently from contributions to out-of-state charitable organizations," and concluded that it was "facially discriminatory." 651 N.W. 2d at 834. As noted above, a law that facially discriminates against interstate commerce necessarily implicates the dormant Commerce Clause. Maryland's tax scheme, which is not facially discriminatory, however, does not necessarily implicate the dormant Commerce Clause. Therefore, like *Camps Newfound/Owatonna* and *Fulton Corp.*, the conclusion that the law in *Chapman* implicated the dormant Commerce Clause is inapplicable to the present case.

In the absence of facial or express discrimination, an undue burden on interstate commerce must be shown.[4] *See Tracy*, 519 U.S. at 287, 117 S. Ct. at 818,

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[4] The Supreme Court in *Dept. of Revenue v. Davis*, 553 U.S. 328, 128 S. Ct. 1801, 170 L. Ed. 2d 685 (2008), articulated the standard for when a nondiscriminatory law can violate the dormant Commerce Clause. It stated that "[a]bsent discrimination for the forbidden purpose [of economic protectionism], however, the law will be upheld unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local

136 L. Ed. 2d at 773 (internal quotation and citations omitted) ("The negative or dormant implication of the Commerce Clause prohibits state taxation . . . or regulation . . . that discriminates against or unduly burdens interstate commerce and thereby impedes free private trade in the national marketplace[.]"). In *Amerada Hess Corp. v. Dir., Div. of Taxation, New Jersey*, 490 U.S. 66, 78-79 n. 10, 109 S.Ct. 1617, 1624-25 n.10, 104 L.E.2d 58, 70 n.10 (1989), the Supreme Court, in considering New Jersey's denial of a state tax deduction for federal windfall profit tax payments, observed that "in the absence of discriminatory intent or a statute directed specifically at economic activity that occurs only in a particular location . . . a deduction denial does not unduly burden interstate commerce just because the deduction denied relates to an

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benefits.'" 553 U.S. at 338-339, 128 S. Ct. at 1808, 170 L. Ed. 2d at 695 (quoting *Pike v. Bruce Church*, 397 U.S. 137, 142, 90 S. Ct. 844, 847, 25 L. Ed. 2d 174, 178 (1970)); *see also Oregon Waste Sys., Inc. v. Dept. of Envtl. Quality*, 511 U.S. 93, 99, 114 S. Ct. 1345, 1350, 128 L. Ed. 2d 13, 21 (1994) (quotations omitted) ("If a restriction on commerce is discriminatory, it is virtually *per se* invalid. . . . By contrast, nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."); *Bd. of Trustees v. Mayor and City Council of Baltimore City*, 317 Md. 72, 134-35, 562 A.2d 720, 750 (1989) (citations omitted) ("With regard to state regulatory legislation, the Supreme Court has long recognized that, while discrimination in favor of local economic interests is usually invalid under the Commerce Clause, nondiscriminatory legislation will be upheld unless the burden on interstate commerce outweighs the local interests effectuated by the legislation."). In the present case, the Wynnes have failed to prove that any alleged burden upon interstate commerce is "clearly excessive" in relation to the local services paid for by the Howard County tax.

economic activity performed outside the taxing State." The Wynnes, in failing to prove discriminatory intent or unacceptable statutory geographical specificity, have demonstrated neither an undue burden on interstate commerce nor an implication of the dormant Commerce Clause.[5]

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[5] In another section of their brief to this Court, the Wynnes argue that the dormant Commerce Clause requires taxes to be apportioned, which can be read as an assertion that an un-apportioned tax might implicate and violate the dormant Commerce Clause. Some un-apportioned taxes could have a significant effect on interstate commerce such that they "unduly" burden interstate commerce, thereby implicating and violating the dormant Commerce Clause. *Amerada Hess*, 490 U.S. at 75, 109 S. Ct. at 1623, 104 L. Ed. 2d at 68. The dormant Commerce Clause, however, does not protect against taxes and laws that have only an incidental effect on interstate commerce. *Fulton Corp.*, 516 U.S. at 331, 116 S. Ct. at 854, 133 L. Ed. 2d at 805. TG § 10-703 provides a credit for state taxes, significantly diminishing any effect Maryland income taxes have on interstate commerce. As noted above there is a strong presumption that an act of the Maryland General Assembly is constitutional. Additionally, the Supreme Court has concluded that "[t]he dormant Commerce Clause protects markets and participants in markets, not taxpayers as such." *Tracy*, 519 U.S. at 300, 117 S. Ct. at 825, 136 L. Ed. 2d at 781. The Wynnes have not provided evidence that any markets or market participants, as opposed to taxpayers, have been disadvantaged by some taxpayers being required to pay slightly more in taxes. Additionally, there is no evidence that, as the Majority fears, interstate commerce will be harmed because taxpayers will have a "disincentive . . . to conduct income-generating activities in other states with income taxes." *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 14). In fact, as the Majority notes, Maryland residents have paid a county tax without a credit pursuant to TG § 10-703 since the tax code was amended in 1975. *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 5-6). There has been no evidence presented to this Court that Maryland

The *Blanton* decision conclusively established that Maryland law applies TG § 10-703' s tax credit only to state taxes, not county taxes. 390 Md. at 543, 890 A.2d at 288. The Wynnes asked this Court to conclude that settled Maryland law is unconstitutional under the dormant Commerce Clause. The presumption has always been that Maryland law is constitutional, and the Wynnes, as challengers of the Maryland tax law, have failed to overcome that presumption by proving that Maryland's tax scheme expressly discriminates against or unduly burdens interstate commerce such that the dormant Commerce Clause is implicated. The Wynnes may believe that it is bad policy to require them to pay the Howard County tax without a tax credit; however, they have failed to prove that it is in violation of the dormant Commerce Clause. Accordingly, I respectfully dissent.

Judge Battaglia joins in the views expressed herein.

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companies or taxpayers have been deterred from engaging in interstate commerce over nearly four decades since 1975. In fact, at issue in the present case is the income generated by the Maxim Corporation, a company founded in 1988, from business in 39 other states where the income was taxed. Thus, even if we were to accept the argument that the federal Constitution requires the apportionment of taxes as a contention by the Wynnes that the dormant Commerce Clause is implemented, the Wynnes have failed to prove this.

APPENDIX B

IN THE COURT OF APPEALS OF MARYLAND

No. 107

September Term, 2011

[Filed May 17, 2013]

MARYLAND STATE COMPTROLLER OF THE TREASURY	)
	)
v.	)
	)
BRIAN WYNNE, ET UX.	)

Bell, C.J.
Harrell
Battaglia
Greene
Adkins
Barbera
McDonald,

JJ.

Opinion on Motion for Reconsideration by McDonald, J.

The Comptroller has filed a Motion for Reconsideration and, Alternatively, a Motion for Stay of Enforcement of the Judgment. The Wynnes opposed that motion. The parties filed memoranda of law and other materials in support of their respective positions.

It appears appropriate to clarify two points raised in the papers submitted by the parties:

(1) The Comptroller raised the question of whether he could deny application of a credit to the Wynnes for income taxes paid by an S corporation, such as Maxim, in another state that does not accord pass-through treatment to S corporation income, but rather taxes the income of such a corporation in the same way that it taxes the income of a C corporation. The parties did not brief, and we did not consider, the ways in which other states may treat S corporation income other than as pass-through personal income of the corporation's shareholders. Our opinion does not foreclose different treatment in Maryland of income taxes paid in other states that are not based on pass-through personal income.

(2) A state may avoid discrimination against interstate commerce by providing a tax credit, or some other method of apportionment, to avoid discriminating against interstate commerce in violation of the dormant Commerce Clause. The Comptroller interprets a footnote in our earlier opinion to hold that a state must provide a tax credit. Slip Op. at pp. 28-29 n.26. While the footnote might have been worded more elegantly, it referred primarily to the method used by the Legislature in the Maryland income tax; we did not

mean to preclude other methods that might be utilized in other contexts.

The Motion for Reconsideration is DENIED; however, we shall STAY the effective date of the mandate pending the disposition of a timely petition for certiorari filed by the Comptroller with the United States Supreme Court.

APPENDIX C

IN THE CIRCUIT COURT FOR HOWARD COUNTY

CASE #: 13-C-10-80987

MARYLAND TAX COURT

Appeal #: 08-IN-00-0791

[Filed June 29, 2011]

BRIAN WYNNE, *et al.*

Petitioners

FOR JUDICIAL REVIEW OF A DECISION OF THE MARYLAND TAX COURT

And

MARYLAND STATE COMPTROLLER OF THE TREASURY

Respondents

MEMORANDUM

This is an appeal from the December 29, 2009 Order of the Maryland Tax Court (J. Silberg), affirming the determination of the Comptroller of Maryland that disallowed credit for out-of-state income taxes paid against the "county" portion of State income taxes due to Maryland pursuant to Md. Code Ann., Tax - General Art., § 10-101 *et seq.*, particularly § TG § 10-703(a).

In this case, this Court must determine whether Maryland's current tax credit procedure under the applicable sections of that Tax Article, when income taxes paid to other states on income earned by Maryland residents are not permitted to be offset by the "county portion of the State income tax," runs afoul of constitutional protections of the Commerce Clause of the U.S. Constitution.

This Court holds that, since the present Maryland's income tax scheme does not permit a constitutional allowable credit for that "county portion" against such income earned and taxed out-of-state, Maryland substantially burdens its residents conducting business in interstate commerce, as compared to those conducting purely intrastate commerce. In finding this statutory scheme unconstitutional pursuant to the Commerce Clause of the U.S. Constitution, this Court reverses the findings of the Maryland Tax Court and remands this case for findings consistent with the following interpretation of the law.

I. PROCEDURAL BACKGROUND

Brian and Karen Wynne ("the Wynnes") contested the determination of their 2006 Maryland income tax liability by filing a complaint with the Maryland Comptroller of the Treasury (the "Comptroller"). A hearing officer from the Comptroller's Office determined that the tax credit permitted for out-of-state taxes paid only applied to the portion owing to "state income taxes" under TG § 10-102, and not to any portion of "county income taxes" under TG § 10-103. The Wynnes appealed to the Maryland Tax Court with the parties going forward on an Agreed Statement of Facts and Stipulation of Exhibits # 14 in Transcript of Record from Maryland Tax Court (Tr.) and Amended Agreed Statement of Facts and Stipulation of Exhibits (Tr # 15). The evidence stipulated to by the parties is summarized at pp. 3-5 of Comptroller's Pre-Trial Memorandum of Law (Tr # 15). After considering oral argument on June 18, 2009 and Memoranda, that administrative body affirmed the Comptroller's determination at a Continued Hearing before it on December 10, 2009. This appeal comes before this Court on judicial review of the Tax Court's decision, as permitted under Tax - General, § 13-532, Md. Code Ann. and Maryland Rule 7-207.

II. FACTUAL BACKGROUND

The Wynnes, longtime Maryland residents, are married with five children. Brian Wynne is one of seven owners of Maxim Healthcare Services, Inc. ("Maxim"), company founded in Howard County in 1988 and since having grown into a nationwide healthcare services provider.

The Wynnes posit that Maxim is an S or "tax pass through" corporation for purposes of both Maryland and federal tax laws. In 2006, the Wynnes earned $2,667,133 in taxable net income; much of it from their 2.4% ownership interest in Maxim. Without tax credits, the Maryland tax on that income would have amounted to $207,984. However, the Wynnes, due to the multi-state nature of Maxim, already paid $84,550 in taxes on some of that income to 39 other states. In some states, a S-corporation, such as Maxim can pay taxes on its shareholders' behalf by deducting those payments from the shareholders' distributions by filing a "composite return", while in other states the corporation pay taxes on its own behalf, and those tax payments become liabilities of the corporation by filing a "corporate return". The Wynnes paid the taxes they owed to other states through a combination of composite and corporate returns. The distinction was relevant to the statutory issues raised before the Maryland Tax Court but not those now on review before this Court. The basis of that out-of-state liability was income generated within the border of those other states. Due to the fact that Maxim is an S-corporation, the Wynnes, as owners, were liable for their share of Maxim's tax liability to other states directly. The Comptroller denied the Wynnes' claim for a credit in the full amount of $84,550 (state taxes paid to other states for income generated within their borders).

Relying on TG § 10-703(a), Md. Code, the Comptroller allowed taxes paid to other states to offset only those taxes owed to Maryland representing "state income tax," and not "county income tax." The Tax Court, in affirming the determination of the Comptroller, found no constitutional basis to overturn

that determination and affirmed, based on prior Maryland judicial and administrative agency interpretations of this statute, stating in its ruling set out in the transcript of the December 10, 2009 Continued Hearing (Tr #22, 6, lines 11 - 20) as to the constitutionality of TG § 10-703's credit procedure with a short reference to the Court of Appeals' decisions in "a number of different cases" including "*Blanton* ... for credits for taxes paid to North Carolina." Referring to *Comptroller v. Blanton* 390 Md. 528, 890 A.2d at 279 (2006) it finally concluded by stating:

> Mr. Blanton wanted to get credit towards both the state tax and the county tax and they said 'it doesn't work.' You don't get the credit, and it's not unconstitutional to do this.

On appeal this Court judicially reviews that decision, promulgated by written order on December 29, 2009, focusing on the issues of constitutional law raised.

III. STANDARD OF REVIEW

Counsel for the Plaintiffs in opening argument before this Court on July 7, 2010 indicated that the issue to be resolved herein involves a very narrow question of constitutional law; thus, this Court should review the case, *de novo*, without deference to what the Tax Court did below. *Frey v. Comptroller*, 184 Md.App. 315, 330 (2009). As Rochvarg, *Maryland Administrative Law*, Md. 2nd Ed., §§ 4.59, 181, points out in the quotation below that term "*de novo*", is somewhat of a misnomer, "... since the Court does not rely on previously created record or a previous decision,

when it hears a case "*de novo*". Further, he states there:

> A "*de novo*" hearing involves testimony of witnesses, introduction of documents and other evidence, opening and closing arguments, and a decision based on the record created at that *de novo* hearing. The phrase "*de novo* review" is an oxymoron because if the hearing is "*de novo,*" there is nothing reviewed; the prior proceeding is a nullity. The only instance in Maryland where there is a *de novo* hearing, following an administrative hearing is in a workers' compensation case. In fact, in Maryland, it appears that *de novo* review would be unconstitutional for agencies other than the Workers' Compensation Commission. State Gov't. §10-2 - 201 with §10-222, entitled Judicial Review.

Rochvarg, *supra*, further indicates at §4-35, 161, Review of Legal Issues that,

> Agency decisions also can be challenged as contrary to law. These legal challenges come in different packages. . . . .First, the agency decision can be challenged as unconstitutional.

At § 4.36, 161, Challenges to the Constitutionality of the Agency Decision, that author further notes:

> If the agency decision violates the Maryland Constitution or those portions of the United States Constitution that apply to the states, the agency decision must be invalidated. Even if there is substantial evidence in the record that supports each factual finding upon which the agency decision is based, if the decision is unconstitutional, it cannot stand.

See *Md. Aggregates Ass'n v. Maryland*, 337 Md. 658, 655 A.2d 886, *cert. denied sub nom. Genstar Stone Prod. Co. v. Maryland*, 514 U.S. 1111 (1995).

As noted by the Court of Appeals of Maryland in *Public Safety v. Demby*, 390 Md. 580, 614, 890 A.2d 310 (2006), a case denying prison inmates confinement credits under certain circumstances, confirmed the following standard for circuit courts reviewing administrative agency decisions:

> In our review of the decision of an administrative agency, we consider the agency's decision pursuant to the "same statutory standards as would the circuit court, and we do not employ those standards to reevaluate the decision of the circuit or intermediate appellate court." *Charles County Dep't of Soc. Servs. v. Vann*, 382 Md. 285, 294, 855 1.2d 313, 318 (2004). Our role is limited to ascertaining whether there exists substantial evidence in the record as a whole that supports the findings and

> conclusions of the agency; we must also determine "if the administrative decision is premised upon an erroneous conclusion of law." *United Parcel Serv., Inc. v. People's Counsel for Baltimore County*, 336 MD. 569, 577, 650 A.2d 226, 230 (1994).

As to the instant case, it is noted that the Maryland Tax Court is an "independent administrative unit of the State government." Md. Code. Ann., Tax - General, § 3-102. *See also Abington Ctr. Assoc. Ltd. Partnership v. Baltimore County*, 115 Md. App. 580, 694 A.2d 165 (1997) (stating that, notwithstanding its name, the court is an administrative agency of the State government but functions in many respects as a court); *Frey v. Comptroller*, 184 Md.App. 315, 330 (2009). The Maryland Court of Appeals has examined, in detail, a court's role in reviewing an administrative agency's adjudicatory decision, and held that a court's task on review is *not* to "substitute its judgment for the expertise of those persons who constitute the administrative agency," *United Parcel v. People's Counsel,* 336 Md. 569, 576-577, 650 A.2d 226, 230 (1990), quoting *Bulluck v. Pelham Wood Apts.*, 283 Md. 505, 513, 390 A.2d 1119, 1124 (1978).

Even with regard to some legal issues, a degree of deference should often be accorded the position of the administrative agency below. Thus, an administrative agency's interpretation and application of the statute which the agency administers should ordinarily be given considerable weight by reviewing courts. *Lussier v. Md. Racing Commission*, 343 Md. 681, 696-697, 684 A.2d 804, 811-812 (1996), and cases there cited;

McCullough v. Wittner, 314 Md. 602, 612, 552 A.2d 881, 886 (1989) ("The interpretation of a statute by those officials charged with administering the statute is . . . entitled to weight."). Furthermore, the expertise of the agency in its own field should be respected. *Bd. of Ed. for Dorchester* Co. *v. Hubbard*, 305 Md. 774, 792, 506 A.2d 625, 634 (1986) ("application of the State Board of Education's expertise would clearly be desirable before a court attempts to resolve the" legal issues); *Maryland Aviation Administration v. Noland*, 386 Md. 556, 571-72, 873 A.2d 1145, 1154-55 (2005), quoting *Board of Physician Quality Assurance v. Banks*, 354 Md. 59, 68-69, 729 A.2d 376, 381 (1999) (alternation in original) (alterations added) (footnote omitted).

It has been held that recognizing the agency's decision is "prima facie correct and presumed valid," "we must review the agency's decision in the light most favorable to it." *Comptroller of the Treasury v. Citicorp Int'l. Commc'ns*, 389 Md. 156, 163, 884 A.2d 112, 116 (2005) (quoting *Ramsay, Scarlett & Co. v. Comptroller*, 302 Md. 825, 834-35, 490 A.2d 1296, 1301 (1985)); Md. Code § 13-411 of the Tax-General Article ("[a]n assessment of tax . . . is prima facie correct").

As noted by Rochvarg above, a *de novo"* review of matters of law in an administrative judicial review, as the instant case raising mainly legal issues of constitutionality still involves an examination of the record created below of testimony of witnesses, of documents and other evidence, opening and closing arguments, and with appropriate deference being giving to the decision of the agency but also the weighing, *de novo*, of the arguments in the memoranda filed and orally at the judicial review hearing. Unless

the Tax Court's decision herein was erroneous as a matter of law, or its conclusion was not supported by substantial evidence, this Court must affirm that decision. *See Citicorp*, 389 Md. at 164, 884 A.2d at 117; *CBS v. Comptroller*, 319 Md. 687, 697-98, 575 A.2d 324, 329 (1990) (internal quotations and citations omitted).

This Court is well aware of the following standards to be applied when it judicially reviews a statute or statutory scheme for constitutionality:

> In deciding the constitutionality of a statute, we begin with the presumption that the statute is valid. *Galloway v. State*, 365 Md. 599, 610, 781 A.2d 851 (2001), *cert. denied*, 535 U.S. 990, 122 S.Ct. 1547, 152 L.Ed.2d 472 (2002). We will not find a statute unconstitutional if, " 'by any construction, it can be sustained.' " Id. At 611, 781 A.2d 851 (quoting *Beauchamp v. Somerset county* 256 Md. 541, 547, 261 A.2d 461 (1970). When the challenge to a statute is based on vagueness, the burden of establishing unconstitutionality is on the party attacking the statute.
>
> *Livingston v. Maryland*, 192 Md. App. 553, 568 (2010).

See also *Fell v. Maryland*, 42 Md. 71, 77 (1875) which held:

> Courts will not pronounce a statute unconstitutional, unless it is plainly and undoubtedly a violation of the Constitution. All presumptions are in favor of the law, and to

doubt at all, is to resolve the case in favor of the statute.

Thus, applying those legal standards, this Court will focus on reviewing the legal underpinning and conclusions of the Tax Court's ruling.

IV. ANALYSIS

The specific issue in this case is whether the Tax Court's interpretation of § 10-703(a) of the Tax-General Article, Md. Code, allowing for a credit solely against the "state" portion but not the "county" portion tax of the Maryland State income tax, is constitutionally proper under the Commerce Clause of the U.S. Constitution, Article 1, Section 8, Clause 3, (U.S.C.A., §8, cl.3) known as "the dormant commerce clause". For the following reasons, this Court finds it is violative of that clause and is, thus, unconstitutional.

A. Overview of Maryland's Tax Credit Procedure

1. FULFILLMENT OF CONSTITUTIONAL REQUIREMENTS

Maryland, like most other states, taxes income earned by its residents. *See generally* Md. Code Ann., Tax-General Art., § 10-101 *et seq.* (setting forth mechanism for assessing and collecting taxes income tax from individuals and other entities). The General Assembly has promulgated a system under the Tax-General Article, whereby state income tax consisting of two different components is imposed on all Maryland residents and out-of-state individuals conducting

business in Maryland: (1) a "State income tax" and (2) a "county income tax or local income tax."[1] TG §§ 10-105 & 10-106. Depending on the county of residence of the taxpayer, the rate of local income tax paid by the individual will vary. *See* § TG 10-106 (explaining that each Maryland county, subject to State law promulgating certain minimum and maximum rates, sets out its applicable county income tax rate).

It is clear that sovereign jurisdictions such as Maryland have the authority to levy taxes on residents and any other individuals conducting activity within their borders, whether they are intended to generate revenue for the state or for their constituent localities. Such taxes are necessary to provide for the common welfare of a state's residents. Furthermore, constitutional jurisprudence affirms the states' rights to tax their residents on all income earned from whatever source, at least subject to the limitations imposed under the Due Process Clause of the Constitution. *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937). However, the state taxation at issue implicates another constitutional limitation on it separate from the Due Process Clause: namely, the Commerce Clause.

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[1] Out-of-state individuals conducting business in Maryland, who are not subject to a "local income tax" because they are not domiciled in the state, are subject to a special non-resident tax imposed on income earned in Maryland. TG § 10-106.1. The rate of tax mirrors the lowest prevailing county tax rate for the year and is collected and applied towards the Maryland General Fund. *See Frey v. Comptroller*, 184 Md.App. 315, 965 A.2d 923, (2009) *cert. granted*, Md. , 972 A2.d 861 (2009). Currently, this rate is 1.25% (reflecting the county tax rate of Worcester County).

While the Due Process Clause of the Constitution permits states to tax their residents on all income earned regardless of the source, i.e., they can levy taxes on all of their residents' out-of-state earnings, the Commerce Clause provides a second, much more stringent restriction on the states' ability to tax. *See Quill Corp v. North Dakota*, 504 U.S. 298 (1992) (explaining that, while there is some overlap in these constitutional requirements, they are "analytically distinct"). The Due Process Clause is primarily concerned with the ability to tax based on sufficient nexus; in the case of state residents, there is such nexus establishing the ability to tax because the inhabitants of a state by virtue of their residency have subjected themselves to the rights and privileges of the state, such as access to public services and the protection of state law. The Commerce Clause is not concerned with the ability of a state to tax its residents purely based upon that nexus; instead, it was promulgated to ensure that a state is not using taxation in such a way as to impermissibly enter into the federal realm by negatively affecting interstate commerce to a significant degree. If a state's taxing procedures, as a whole or in part, significantly burden interstate commerce, that activity is analytical dissected as such and then labeled as violating the "dormant Commerce Clause".

Although discussed more fully *infra*, such violation of the dormant Commerce Clause will necessitate striking down a state statute or taxation scheme if found to effectively result in double or multiple taxation. *See Hellerstein*, State Taxation: 3rd Edition, ¶ 20.10[2][b], an authoritative text referenced for decades by the U.S. Supreme Court, in taxation cases

(explaining that multiple taxation is an unconstitutional risk and, explaining how the taxing by states based purely on residency, needs to provide credit mechanisms to prevent multiple taxation). That is, if a statute either expressly or effectively imposes any tax on a taxable event or other basis when a tax(s) has already been imposed by another jurisdiction having primary authority to tax (*i.e.*, where the income being taxed is "sourced", explained *infra*), the statute will likely be unconstitutional. In income taxes matters, to not run afoul of the dormant Commerce Clause, a state must either confine its taxation to those events occurring within its borders or, alternatively, must provide remedial or balancing measures, i.e., appropriate and reasonably proportionate tax credits for taxes paid to another state for income sourced there, when exercising its jurisdiction to tax on all income of its residents, wherever earned.

2. HISTORY OF MARYLAND OUT-OF-STATE INCOME TAX CREDITS

Maryland, like many other states, has attempted to meet its constitutional burdens under the Commerce Clause by instituting a comprehensive income tax credit scheme under TG § 10-701 *et seq*. See also *Hellerstein* at 20.10[2][b] (stating that "At a minimum, we believe that the Commerce Clause would bar a state's absolute denial of a credit to residents who engage in commercial activity across state lines regardless of the source of their income."). This remedial or balancing measure provides generally that, when a Maryland resident has been taxed on income earned in another state, Maryland will offer a credit corresponding to the amount of tax liability in order to

negate any double taxation.[2] The first iteration of this mechanism was put in place in 1939 and remained constant until *Stern v. Comptroller,* 271 Md. 310, 316 A.2d 240 (1974). When that latter case came before the Court of Appeals in 1974, the tax credit for out-of-state taxes paid was determined at *Stern*, 271 Md. at 311 as follows:

> The relevant statutory material is found in Maryland Code (1957, 1969 Repl. Vol.) Art. 81. The credit allowed Maryland residents for income taxes paid another state was provided by Chapter 277, § 12 of the Laws of 1939, which became section 224 of Article 81, and survives unchanged as section 290" ":
>
> > "Whenever a resident individual of this State has become liable for income tax to another state upon such part of his net income for the taxable year as is properly subject to taxation in such state, *the amount of income tax payable by him under this subtitle* shall be reduced by the amount of the income tax so paid by him

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[2] For example, if Taxpayer, a State X resident earned $100,000 in State X (tax rate of 10%) he would have a tax liability of $10,000 (owed to State X). If, however, Taxpayer earned the $100,000 in State Y (tax rate of 10%) and State X taxed its residents on all income wherever earned but incorporated tax credits to avoid double taxation, taxpayer would still have a $10,000 tax liability. Taxpayer would owe $10,000 to State Y (where income generated), and the State X pre-credit tax liability would be $10,000; however, the credit of $10,000 in State Y would exactly offset this and result in no tax liability.

> to such other state upon his producing to the Comptroller satisfactory evidence of the fact of such payment; but application of such credit shall not operate to reduce the tax payable under this subtitle to an amount less than would have been payable if the income subjected to tax in such other state were ignored. . . ."

Furthermore, in *Stern*, 271 Md. at 311 relying on the plain reading of this statute and not constitutional analysis, the Court of Appeals determined that the Sterns could credit out-of-state income taxes paid against the state tax liability and "that portion of their Maryland income tax which would be collected by the Comptroller and paid to the county where the Sterns reside."[3] **Significantly the appellate court in *Stern* held the county or local income portion of the tax to be a tax imposed by the State of Maryland.** Apparently in response to that court's decision, the General Assembly enacted emergency legislation in an attempt to reduce revenue lost (from local or county income taxes) by the interpretation of the statute in *Stern*.

Later in 2006 the Court of Appeals, in *Comptroller v. Blanton,* 390 Md. 528, 541, 890 A.2d at 287 gave a

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[3] It should be noted that *Stern* was decided by the Court of Appeals in 1974 while *Coerper v. Comptroller, 265 Md. 3. 288 A.2d 187* was decided by the Court of Appeals in 1972. Under the same logic as applied by that court (in *Stern*), which did not change even in light of the statutory amendment, *Coerper* is neither authoritative nor binding or even guiding on the principles of local income tax credits in this scenario as well.

synopsis of the legislative and case law history including the *Stern* decision and the Maryland General Assembly's reaction to the appellate court in *Stern*:

> In February 1975, the Legislature enacted emergency legislation, amended § 290 by adding § 290(b), which provided that only the income tax portion of the State tax could be reduced and no reduction from the local tax portion would be permitted. *See* Ch. 3 of the Acts of 1974 (stating that the § 290(b) was amended as an emergency repeal and re-enactment for the "immediate preservation of the public health and safety . . ."). Section 290(b) provided, in relevant part:
> § 290. Credit allowed residents.
> (b) . . . [W]ith respect to the taxable year 1974 and each taxable year thereafter, the credit provided for by this section operates to reduce **only** the State income tax payable under this subtitle and does not operate to reduce any local income tax imposed. . . .

Md. Code (1957, 1975 Repl Vol., 1976 Cum. Supp.), Article 81 § 290(b)."

That version of the Code was replaced in 1988, when the Legislature passed Senate Bill 1. In doing so, previous Sections 290(a) and (b) became Maryland Code (1988), § 10-703(a) of the Tax-General Article. While the new statute had minor modifications in its wording, the effect remained the same. In *Blanton*, the Court of Appeals stated that, although no legislative history was submitted with the revisions and the new statute omitted "only" in referring to "State income

taxes," the substance remained the same. *Comptroller v. Blanton* 390 Md. 528, 543, 890 A.2d at 288. Therefore, in that limited context the plain construction of the statute precluded crediting against any local or county income tax. *Id.* However, it is extremely significant that neither the *Stern* nor *Blanton* courts ever relied upon constitutional bases for deciding this issue; in each, it was always purely a matter of statutory construction.

3. EXPLANATION OF *BLANTON*, *COERPER*, *HICKEY* AND *FREY* CASES

While no Maryland case has ever explicitly dealt with the constitutionality of the current procedures for out-of-state income tax credits, whether it be under the Due Process Clause or Commerce Clause, this Court, nevertheless, finds the Tax Court was mistaken in its decision in that regard. The Tax Court Judge opined in his ruling set out in the transcript of December 10, 2009 Continued Hearing (Tr #22) on the constitutionality of TG § 10-703's credit procedure:

> ...it's been heard before, and the Court of Appeals has affirmed this section in a number of different cases...The same statute came up in *Blanton* for credits for taxes paid to North Carolina. Mr. Blanton wanted to get credit towards both the state tax and the county tax and they said 'it doesn't work.' You don't get the credit, and it's not unconstitutional to do this.

Although *Blanton*, *Coerper*, *Frey* and *Comptroller v. Hickey*, citing at 114 Md.App. 388 (1997) all deal with the application of the taxes or tax credits for non-state

level income taxes (i.e. "local tax or county income tax or county portion of the state income tax"), only *Blanton* dealt specifically with TG § 10-703(a); but even that case did not focus on nor was it decided on constitutional grounds.

While *Blanton*, 390 Md. 528, did refer to TG § 10-703(a) and the credit procedure, and the appellate court found that taxes paid to other states were not creditable against "local taxes," it did so on the basis of statutory interpretation and not on constitutionality. Therefore, *Blanton* provides really no or very little guidance on the constitutionality of this section. Furthermore, as explained *infra*, while the two Maryland appellate court have each ruled on TG § 10-703 on two separate occasions, only *Blanton* has specifically dealt with TG § 10-703(a) regarding the credit procedure.

The other cases dealing with or related to TG § 10-703 were as follows and specifically involved the statutes so indicated: in *Hickey*, TG § 10-703(c)(1) (on maximum allowable credit against state tax liability); in *Coerper*, as to the predecessor to TG § 10-201 (on the proper taxable base for determining local income taxes due), and in *Frey,* TG § 10-106.1 (on the constitutionality of the special non-resident tax "SNRT"). While the Comptroller argues that the issues raised by the Wynnes are foreclosed by precedent set in *Comptroller of the Treasury v. Blanton*, 390 Md. 528, 890 A.2d 279 (2006), this Court finds, as discussed below in detail, the issues of constitutionality raised herein, being ones of first impression, are not foreclosed by any previous ruling of either the Maryland Courts of Appeals or Special Appeals.

As noted the *Blanton* court dealt with the application of the tax credit procedures in TG § 10-703 but focused on the statutory interpretation of this statute and not the constitutional limitations on Maryland's ability to tax its residents.

In *Blanton*, Maryland residents challenged the Comptroller's determination of their state tax liability. Specifically, the taxpayers in that case attempted to have taxes paid to other states credited against their Maryland tax liability: both the "state" and "local" portions. While the factual situation was analogous to that in the present case, the *Blanton* petitioners argued, and the court ruled, only on the ability of the taxpayers to credit these out-of-state taxes against "local" taxes under the statute as it was and is presently written. The appellate court, in reversing the reviewing circuit court held, purely as a matter of statutory interpretation of legislative intent, that under TG § 10-703, the taxpayers were only allowed to apply credit against "the State income tax." Since the statute provided for two levels of tax, "State" and "local," a plain reading of the statute brought about the conclusion that credits were inapplicable to the "local" portion. The *Blanton* opinion never specifically addressed the issue of constitutionality.

The Comptroller urges in the instant case, however, that *dicta* found in a footnote in *Blanton,* leads to a sufficient conclusion that Maryland has previously addressed any "double taxation" issue and that the Court of Appeals has found no impermissible taxation under the Commerce Clause. Footnote 9 at 390 Md. 536-537 reads as follows:

The Blantons argue that a violation of this State's policy against double taxation occurred when the Blantons were not allowed a credit for the full amount they paid toward North Carolina income taxes.

We find that the Blantons' double taxation argument is unpersuasive. The Legislature resolved the double taxation issue by providing a credit toward State income tax under § 10-703 of the Tax-General Article. Although § 10-703 was enacted to allow taxpayers to avoid double taxation to some extent, it also required that Maryland receive, at the least, the income tax on the income attributable to Maryland, regardless of the amount paid to another state. *See Comptroller v. Hickey*, 114 Md.App. 388, 401, 689 A.2d 1316, 1322 (1997); § 10-703 (c) (1) (i) and (ii) of the Tax-General Article.

Further, the Blantons argue that they should pay local tax on the amount earned in Maryland and not on the adjusted gross income for federal income tax purposes, which included income from both states. In response to the Blantons' contention, we turn to *Coerper v. Comptroller*, 265 Md. 3, 6, 288 A.2d 187, 188 (1972), where the taxpayer maintained that the amount paid to New York in income tax should be deducted from his state and county income taxes. The Court held that if the taxpayers were allowed to pay a lesser amount of county income tax, it "would have the possible absurd result of the Coerpers paying little or no local tax for the services provided by the county while a neighbor

> with similar income, exemptions, and deductions might be paying a substantial local tax to support those services." *Id.* at 8, 288 A.2d at 189.
>
> The court continued, writing that [t]he key word here is "credit." The General Assembly granted a credit against the tax liability of a taxpayer. When it referred to state income tax liability it meant the amount of tax computed as due from a taxpayer on his income after allowance of the usual deductions and exemptions. The fact that there might be credited against that tax liability losses arising from . . . sums paid other states for income taxes was not intended to reduce one whit the liability of the taxpayer or the sum payable by the taxpayer to the local subdivision. *Id.* In light of our holding in *Coerper*, we reject the Blantons' contention.

A full reading of this footnote, which again is *dicta* and not binding, shows that the holding of the Court of Appeals is neither on point with the issue raised in the instant case nor respectfully is it technically totally accurate. First, it is necessarily true that legislation in this state must comply with the federal Constitution and that, in order to do so, Maryland must endeavor to have a tax structure which fully, or at least significantly, avoids double taxation, and not just "to some extent." This principle will be discussed more fully *infra*. Second, while the Comptroller points out that Maryland is to receive "at the least, the income tax on the income attributable to Maryland, regardless of the amount paid to another state," this point does not directly relate to the issue here (whether tax credits may be taken against the "local tax" liability), but it

instead stands for the proposition that credits related to income earned in other states cannot reduce the tax liability owed to Maryland for income earned by the Maryland resident in Maryland. A quick example illustrates the limiting effect of TG § 10-703(c)(1), as explained in *Hickey*, 114 Md.App. 388, 395, 689 A.2d 1319:

> *Example 3*-TP earned $100,000; of this, $60,000 was earned in Maryland, and $40,000 was earned in State X. State X taxes income earned in that state at 15%. Maryland taxes income at 10%. Under section 10-703(c) (1) (i), TP would pay $6,000 ($40, 000 * .15) in taxes to State X. Under section 10-703(c) (1) (ii), TP's credit would be equal to $4,000 (($100,000 * .10) – (($100,000–$40,000) .10)). Therefore, TP's credit would be limited to $4,000. TP would have to pay $6,000 (($100,000 *.10) – $4,000) in taxes to Maryland.

Basically, this part of the statute, TG § 10-703(c) (1), is aimed at preventing Maryland's relinquishment of tax revenue via another state's imposition of tax at a higher rate. It should be noted, however, that this statute is aimed at retaining tax revenue sourced to Maryland, *i.e.*, getting all taxes otherwise due by Maryland residents for income generated in Maryland. In the sense that *Hickey* uses the phrase "income attributable to Maryland" (to which tax liability may not be reduced), this Court finds the statute means income earned within the state of Maryland and not income taxed based purely on Maryland residency.

Furthermore, although the opinion in *Coerper v. Comptroller*, 265 Md. 3 288 A.2d 187, (1972) (addressed in the footnote) is not dispositive as it addressed the predecessor statute to TG § 10-703, the holding of that case does not bear on our current analysis. In that case, the Court of Appeals determined whether the local income tax authorized by former Art. 81, § 283(a) of the Code is to be "a percentage of the liability of such resident for State income tax" *before* or *after* application of the credit provided in § 290 of Art. 81. The Court held that the local tax is a percentage of the liability before application of the credit and provided the following example, illustrative of its holding:

> An example of a practical application of the *Coerper* argument can be seen in this hypothetical situation. If a taxpayer's income tax liability to the State of Maryland for 1968 were $1,185.89, but he received a credit for taxes paid to another state in the amount of $1,158.74, the balance then remaining due the State of Maryland would be $27.15. If that taxpayer resided in a county imposing a local tax of 35% of the state income tax liability, as some counties did, the amount of local tax due the county would be $9.50. A next door neighbor with similar income, exemptions, and deductions, but with no credit for income tax paid to another state, would pay his county $415.06 income tax. Under the *Coerper* argument the language of § 292, § 288 (g), and Art. 23, § 427, to which we have alluded, would also call for the deduction of those items in the computation of "state income tax liability" and

> place the "piggy back" tax on the remaining result. 265 Md. at 8

Thus, the holding in *Coerper* is limited to the determination that the base for Maryland local income taxes is made prior to any offset for a credit based on taxes paid to another state. Again, *Coerper* deals with identification of the tax base, i.e. whether the taxable amount is pre- or post-credit, and not whether a tax credit may be taken against the county or local portion of the State income tax liability. Here, the issue is not the appropriate base for imposing the "local income tax," but instead is whether taxes paid to other jurisdictions must be credited against the amount owed to Maryland as "the local or county tax or the county portion of the state income tax" (on a pre-credit basis).

Lastly, in *Frey v. Comptroller*, 184 Md.App. 315 (2009), *cert. granted*, the Court of Special Appeals dealt with the constitutionality of the Special Non-Resident Tax ("SNRT") imposed under TG § 10-106.1. In holding that that latter tax did not violate the Equal Protection Clause, Commerce Clause, or Privileges and Immunities Clauses of the U.S. Constitution, the appellate court explained that *Blanton* did not determine whether the local tax imposed under TG § 10-106 was a state tax for constitutional purposes, but only that the local income tax did not fall within the meaning of "only against the State income tax" under TG § 10-703(a). Most significantly as relates to this Court's analysis and ruling herein, the appellate court went on to state, in likening "SNRT" to the "local income tax:"

> In appellants' case, the Circuit Court for Anne Arundel County correctly noted: "The Court of Appeals' observation in *Blanton* that the State tax and the local tax are two distinct taxes does not mean that they are imposed by different authorities." **The State and county taxes are different, but that does not mean that they are not both State taxes. They are imposed by the same authority. The local tax is not imposed by the county, it is imposed by the State. We thus conclude that the local income tax imposed under T. G. § 10-106 is a State tax. (Emphasis supplied.)**
>
> **Id. at 352.**

Thus, while no court has determined whether forbidding a credit for "county income tax" for out-of-state taxes paid violates the Commerce Clause, at least the appellate court in *Frey* determined that "county income tax" is a state tax. This Court determines that that holding is clearly binding for purposes of its *de novo* constitutional analysis herein.

Since no prior case has dealt with the merits of whether TG § 10-703(a) passes constitutional muster, this Court now addresses the Petitioner's arguments as to why the application of this Md. Code section by the Tax Court violates the Commerce Clause of the U.S. Constitution.

B. "Interstate Commerce" Is Impermissibly Involved

In order for a statutory scheme to meet constitutional requirements under the Commerce Clause, a law must not discriminate or burden interstate commerce. That is, at a threshold level, a statute must at least implicate "interstate commerce" before a Commerce Clause analysis is merited. The Comptroller contends that TG § 10-703 does not succumb to a constitutional attack on the basis of the dormant Commerce Clause because nothing within the "local income tax" mechanism implicates "interstate commerce," at least as applied to the Wynnes and/or their income earned, as S-corporation shareholders, through Maxim. Specifically, the Comptroller urges that this is so because (1) the Wynnes' "passive investment" in a Maryland S-corporation cannot implicate interstate commerce, (2) no interstate economic activity or market is identified, (3) Maryland's local tax scheme effectuates a legitimate local interest and does not differentially burden in-state or out-of-state economic interests, and (4) that "local" income taxes and the corresponding credits do not affect interstate commerce.

It should be noted from the outset that in *Frey,* the Court of Special Appeals has previously held that the imposition of the Special Non-Resident Tax ("SNRT") under TG § 10-106.1 implicates the Commerce Clause. That court rather succinctly stated: "In the present case, since the law firm is doing business in Maryland and appellants, Pennsylvania residents, are partners in the law firm and thus earn income in Maryland, which is taxed under the SNRT, the Commerce Clause

applies." 184 Md. App. at 335, 965 A.2d at 935. While that case involved the imposition of tax on a partnership, not an S-corporation, it is notable that the appellate court held that a tax imposed by Maryland on out-of-state residents for business performed in Maryland was enough to implicate the Commerce Clause. Since the operation of the SNRT is applied similarly in effect to all non-resident owners in pass-through entities, *i.e.*, partnerships and S-corporations, the Commerce Clause is implicated by the mere operation of an income tax on in-state income against out-of-state residents. This logic requires that the exact opposite effect, *i.e.*, the assessment of income tax on out-of-state income against in-state residents, implicates the Commerce Clause as well.

While the logical conclusion of *Frey* is that interstate commerce is affected by TG § 10-703, this Court will further analyze and explain why it will not adopt those Comptroller's contentions, which it finds are erroneous in this case.

1. PASS-THROUGH INVESTMENTS IN S-CORPORATIONS ARE NOT "PASSIVE."

The Comptroller argues strongly that the situation at issue does not implicate "interstate commerce" because the taxpayer's income is "passive" in character. This Court finds the income is not passive in character, as the taxpayer's income is "pass-through" due to the nature of the entity involved (an S-corporation). Furthermore, even assuming *arguendo* that the taxpayer's income was passive, it finds the statute still impermissibly burdens interstate commerce.

A plain reading of the statute leads to the conclusion that Maryland law dictates that the income, generated by the S-corporation and passed through to its shareholders, is sourced and characterized at the entity level (*i.e.*, the S-corporation level). Under TG § 10-101, an S-corporation is defined as "a corporation that elects to be taxed as a small business S-corporation under Subchapter S of the Internal Revenue Code." Furthermore, as to the necessity to apply federal income tax law when interpreting Maryland's income tax statutes, TG § 10-107, dictates that: "To the extent practicable, the Comptroller shall apply the administrative and judicial interpretations of the federal income tax law to the administration of the income tax laws of this State." Thus, while nothing in the Maryland income tax statutes explicitly determines the character or source of income received by S-corporation shareholders through distributions, 26 U.S.C. § 1366(b) does as follows:

> **Character passed thru.** The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation.

Read together, those statutes compel this Court to find that any income earned by S-corporation shareholders, for purposes of Maryland's income tax laws, is characterized "in the same manner as incurred by the corporation." Also, nothing in the facts in the record in this case permits a finding that Maxim earned its income through passive means (and thus

passed through that character of income to the Wynnes).

"Passive investment income" pursuant to the Internal Revenue Code is rather narrowly defined for S-corporation purposes in § 1362(d)(3)(C): "Except as otherwise provided in this subparagraph, the term 'passive investment income' means gross receipts derived from royalties, rents, dividends, interest, and annuities." It should be noted, however, that this definition is only applied in determining a penalty tax for S-corporations with accumulated earnings and profits and for terminations of S-corporation elections. Under a wholly different Internal Revenue Code provision, "passive activities" are defined as "trade or business activities in which you do not materially participate" or certain "rental activities." 26 U.S.C. § 469. This section is aimed at limiting a taxpayer's ability to offset income from earned or ordinary sources with "passive" investments. Neither of these two sections of the Internal Revenue Code has any bearing on the Petitioner taxpayers' situation in the instant case, as the Comptroller argues it does.

Other states have confirmed this view of the characterization of income rules for distributions under similar statutes; that is, the pass-through of items by an S-corporation to its constituent shareholders does not change the character of the item. In *Camacho v. Iowa Dept. of Rev. and Finance,* 666 N.W.2d 537, 540 (Iowa 2003), the Supreme Court of Iowa made a determination on whether certain interest earned in a bank account titled in the name of a non-resident S-corporation, was taxable by Iowa. *Id.* at 539. The question of whether the income was classified as

business income or non-business income required an interpretation of the federal Internal Revenue Code. *Id.* at 540. (The Iowa tax code provided that interpretations of the Iowa Code, when dealing with S-corporations and where no specific authority was given by statute, were to be made in accordance with the Internal Revenue Code.) Emphasizing the flow-through nature of the S-corporation (and its similarity to a partnership), and finding that the interest was not "business income," the Iowa court stated:

> The fact that an item is passed through does not. . .change the character of the item. In other words, any item passed through to shareholders will be treated "as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation. *Id.*

Similarly the Ohio Supreme Court in *Agley v. Tracey*, 719 N.E.2d 951, 954 (1999) held that the "business income generated by an S-corporation retains its status as business income as it passes through to the shareholders." There in a fact pattern analogous to *Camacho* (*i.e.*, the issue involved whether income was business or non-business), the Ohio appellate court also relied upon the characterization rules as used under the Internal Revenue Code. Citing to § 1366(b), the Court stated that:

> ...the character of the item distributed to a shareholder is to be determined as if the item were realized from the source from which the corporation realized the item. **Thus, business income generated by an S-corporation**

retains its status as business income as it passes through to the shareholders." *Id.* at 268.

This same result is explained again, in great detail, in *Valentino v. Franchise Tax Bd.*, 105 Cal.Rptr.2d 304 (4th Dist. 2001). In explaining how California responded to the creation of Subchapter S of the Internal Revenue Code, the Court stated:

> California imposes a tax on the entire taxable income of every nonresident to the extent it is derived from sources in this state. (§ 17041, subd. (b).) As summarized above, California has essentially adopted federal tax law regarding the treatment of subchapter S-corporations. (§ 23800, subd. (a).) Thus, following federal tax law, the character of a shareholder's pro rata share of S-corporation income is determined as if the income were realized directly from the source from which realized by the corporation. (26 U.S.C. § 1366(b).). This principle is known as the "conduit rule" and was intended by Congress to be the same as the partnership rule. (Sen.Rep. No. 97-640, 2d. Sess. (1982), reprinted in 1982-2 C.B. 718, 725; Eustice & Kuntz, Federal Income Taxation of S-corporations (3rd ed.1993) ¶ 7.07[5], p. 7-97; Rev. Rul. 87-121, 1987-2 C.B. 217; Christian & Grant, Subchapter S Taxation (4th ed.2000) H 16.10, p. 16-27.) **"As in the case of nonresident partners, nonresident S-corporation shareholders may be taxed by a state only to the extent the income claimed to be subject to tax is fairly attributable to activities of the S-**

corporation in the taxing state." (Willson & Windfeld, Tax Management Multistate Tax Portfolios-State Taxation of Pass-Through Entities: General Principles, No. 1500 (BNA 1998), p. 43.) ***Id.*** **at 308.**

Thus, the overwhelming consensus rule, in applying income tax statutes of various state which defer to the Internal Revenue Code's sourcing and characterization of income rules for S-corporations, is to treat the income as if it were realized by shareholders from the source brought to fruition by the S-corporation. This principle is further supported by Maryland's own policy of taxing the pro-rata distributive shares of non-resident shareholders via the generation of that income by a S-corporation doing business in Maryland. See TG § 10-102.1 (setting forth the procedure for withholding taxes due from non-resident S-corporation shareholders at the S-corporation level). As the Petitioners correctly point out, this is the only way that Maryland can legitimately tax such individuals (*i.e.*, if such income was not characterized in relation to the S-corporation, the income would be "passive" and no nexus would exist for Maryland to tax such shareholders); furthermore, a uniform application of this rule would result in the Wynnes and other Maryland residents receiving distributions from S-corporations doing business in other states to be classified based upon the characterization of income at the corporate level (and passed through). Here, the uniform application of this principle applied in concert with Internal Revenue Code § 1366(b) and the prevailing interpretations of this statute, requires that the income received by the Wynnes not be deemed "passive" just by virtue of their being shareholders. Its

character is necessarily determined by reference to how Maxim earned such income, *i.e.*, whether it was from services rendered (active) or from investments in other entities (possibly passive). No such information is given on the record in the instant case adequately supporting a finding that such income is passive.

Petitioners are found, on three of the following bases, to have refuted the Comptroller's arguments that that the Wynnes play no "active role in the administration or management of the Maxim corporation and/or the Wynnes merely earn money from "passive investments", in the same way that the holder of a traditional C Corporation stock receives an annual dividend:

First, the record reflects Brian Wynne as president of Maxim Corporation, was intimately involved in the management of the business in 2006 from which he drew an annual salary on which he paid federal and state income tax.

Secondly, the argument made by the Comptroller that income generated by S-corporations and distributed to shareholders is passive, levied on the shoulders of the Wynnes as individual Maryland residents and not part of interstate commerce as such, flies in the face of Maryland's tax scheme as applied to out-of-state S-corporations and out-of-state shareholders generating income in Maryland. If the Comptroller's interpretation of S-corporation taxation rules were accurate, Maryland would be unable to tax out-of-state S-corporations unless they had made distributions to in-state resident shareholders. That is so because, if S-corporation income was always sourced

in relation to shareholder residency rather than the income's source of generation (because it is always passive), Maryland could only tax Maryland resident shareholders; illustrated differently, out-of-state shareholders would not be taxable by Maryland on any income earned by an S-corporation (and distributed to them) regardless of the type of income.[4] This position is simply incorrect and, on analysis, is not found to be carried through in related regulations implementing income taxes on non-resident S-corporations and shareholders.

While it is clear that the income earned by the Wynnes via distributions from Maxim is not "passive" by default (but that reference must be made to how Maxim earned such income), it is also apparent that a mere classification or labeling of income as "passive" or "active" is far from the last word on whether or not an activity affects "interstate commerce" as a matter of substantive law.

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[4] This is because, if S-corporation income is sourced based on the residency of a shareholder, out-of-state resident shareholders would have all income sourced out-of-state. If income, even though generated through an S-corporation in Maryland, is "sourced" out-of-state (because of residency) and the shareholder does not reside in Maryland, Maryland will have no taxable nexus to that income (i.e. no domicile or residency and no "sourcing" of income there). Unless Maryland were to impose a tax at the S-corporation level, which is in direct opposition to TG 10-102.1 (which only imposes tax on an S-corporation in order to collect from non-resident shareholders for their taxes due, unlike a corporate level tax), no taxes would be collected from out-of-state shareholders in S-corporations, many of the existing income tax provisions would not make any sense, and the statute would be "internally inconsistent," as discussed *infra*.

Again this second theory of the Comptroller is that the S-corporation's owner's income should be treated as if is passive, be levied on the shoulders of the Wynnes as individual Maryland residents, not realized as directly coming from the corporation as its source. However to adopt it, this Court finds would conflict with several Maryland laws as explained below.

The third position of the Petitioners, which the Court adapts, in not accepting the Comptroller's argument that the Wynnes' S-corporation income was passive when it came as stock dividends, and thus, does not affect interstate commerce, is that, even if it were deemed passive, the Commerce Clause would still apply, as Maryland's tax procedure would discourage domestic corporations from plying their trade in interstate commerce. Thus, even if income were deemed passive, under the standards set out in the *Fulton* case and other discussed later below the dormant Commerce Clause would still apply.

Although the Comptroller attempts to show that such a qualification matters in this instance, case law as well as sound public policy mandate a finding that both passive and actively generated income can affect interstate commerce, and, thus, implicate the Commerce Clause. The Comptroller cites to a variety of cases that arguably support the proposition that a taxpayer's receipt of passive income was too "remote and speculative to constitute a dormant commerce clause violation" including *In re Mallinckrodt*, No. 807553, N.Y.Tax.App.Trib., Nov. 12, 1992, 1992 WL 346998. First the Court notes that the Tax Appeals Tribunal in *Mallinckrodt* not once, even in passing, mentioned the term "passive" income in rendering its

opinion nor did it refer to the "dormant Commerce Clause." Furthermore, while it dealt with a resident tax credit being allowable with respect to intangible property held by a resident trust, that opinion only determined that the failure to allow a tax credit for payment of out of state taxes on income payable to beneficiaries earned by New York trusts did not violate the double taxation prohibition on New York residents under the Commerce Clause of the United States constitution. That Tribunal, being only another state's administrative agency, is of little persuasive authority even if such statements were made or inferences arguably drawn from *Mallinckrodt* as the Comptroller opined.

This Court finds the Comptroller seems to be primarily referring to *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 733, 172 (1999), *cert. denied*, 528 U.S. 965 (1999). In that case, the Supreme Court of Connecticut held that the statutory denial of a credit for taxes paid to another state by a state resident with an interest in a trust domiciled there, but where the trustee is from another state, did not violate the dormant Commerce Clause. The case was limited to the circumstances where income was generated through a trust, and not to all passive income, and was premised on the notion that the "incentives and risks have not been sufficiently established so as to result in a dormant commerce clause violation." It should be noted, however, that even though the statute was not found unconstitutional, the court still "reject[ed] the defendant's argument that the commerce clause does not apply because the trusts are not engaged in interstate commerce." *Id.* at 208; *also citing General Motors Corp v. Tracy*, 519 U.S. 278, 300 (1997) (holding

presence of actual or prospective competition between supposedly favored and disfavored entities in a single market determines applicability of the Commerce Clause).

Furthermore, two judges expressed in *Chase Manhattan Bank v. Gavin*, 733 A.2d at 808 a strong dissent noting that the taxing scheme violated the Constitution on both Due Process and Commerce Clause grounds. Specifically, as to the Commerce Clause, that dissent stated that mere risk of multiple taxation, and not necessarily the actuality, is enough to establish the violation of the Commerce Clause, citing *Goldberg v. Sweet*, 488 U.S. 252, 261-62, 109 S.Ct. 582, 102 L. Ed. 2d 607 (1989). The dissenters also reiterated that a state's taxing power must at least bear "fiscal relation to protection, opportunities and benefits given by the state." *Citing Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444, 61 S. Ct. 246, 85 L. Ed. 267 (1940).

The Comptroller seems to argue additionally that cases such as *In Re Barton-Dobenin*, 269 Kan. 851, 9 P.3d 9 (2000) and *Stelzner v. Commission of Revenue*, 621 N.W.2d 736 (2001), support the proposition that either "passive" investment cannot trigger the Commerce Clause or, alternatively, that state taxes and credits do not affect interstate commerce generally. That argument misses the mark.

In *Re-Barton-Dobenin*, which dealt with the Foreign Commerce Clause, not the interstate commerce clause, the Kansas Supreme Court upheld the denial of a tax credit for taxes paid to a foreign country on income received as a partner in a partnership owning income-producing commercial property abroad. While both

stemming from the same Article of the Constitution, these bodies of law are significantly different and the rationale behind the Foreign Commerce Clause is not always consistent with that underpinning of the "interstate" Commerce Clause. See, *e.g.*, *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979) (stating that different policies underlie fair apportionment as between foreign states and the several states and suggesting that the need for uniformity is more paramount in the context of the Foreign Commerce Clause).

Furthermore, *Stelzner* also has absolutely no bearing on the issue currently presented. In *Stelzner*, the taxpayers challenged the validity of a state tax on non-domiciliary residents' entire income under the Commerce Clause. 621 N.W.2d at 737. This case involved the ability of a state to tax, based on "non-residency domiciliary" status, not based upon where the income was actually generated. *Id.* Therefore, it held taxation based upon residency status (i.e., the classification) would not, by itself, implicate the Commerce Clause. *Id.* at 741. Furthermore, unlike in the present case, there was a ruling that the Minnesota statute provided full protection from "multiple taxation" and so this issue was not discussed in the context of Commerce Clause jurisprudence. *See Id.* at 740, n. 1 (stating that, since Nevada, another state involved therein had no individual state income tax, there was no issue of multiple taxation; furthermore, a specific statute protects non-domiciliary residents from multiple taxation in Minnesota by allowing credits).

As indicated, since the income at issue here is neither "passive," nor does the classification of the

character of the income as "passive" versus active", definitively determine whether the Commerce Clause is implicated, the Court will not dispose of this matter on these grounds.

2. IDENTIFICATION OF INTERSTATE MARKET OR ACTIVITY AFFECTED BY TG § 10-703

The Comptroller also argues that the Wynnes have not identified any similarly situated persons with whom they "compete" and have not shown that any "identifiable interstate economic activity or market" is affected by Maryland's tax credit scheme at issue herein. In the Comptroller's opinion, "arguably, the similarly situated persons are other Maryland residents with income from passive investments." As previously ruled, since the Wynnes did not "passively" invest in Maxim, it would be illogical to compare them with other Marylanders with income from passive investments. The more appropriate analogy would be between the Wynnes and other Maryland residents who own shares in S-corporations doing business entirely within the confines of Maryland. The groups to be so compared could also be as broadly defined as Marylanders generating income solely in Maryland and Marylanders with any out-of-state sourced income. Under this analysis, the "economic activity or market" could be broadly viewed as anything generating income. Applying the statute at issue, TG § 10-703, to these two groups of similarly situated persons, it is easy to tell that those generating out-of-state income are systematically denied "local income tax" credits and end up with the higher tax bill (when aggregating in-state and out-of-state taxes). While the Wynnes have

not put forth evidence to show that Maxim's business operations are affected by its Maryland resident shareholders' marginally higher taxes, it is clear that, in the aggregate, the monetary effect on interstate commerce is immense. Indeed, the Comptroller states as much in their argument:

> ...the imposition of the local tax and the denial of a credit against the tax do not impermissibly give Maxim an incentive to transfer all of its operations into Maryland. Rather, if anything, it may provide an incentive to the Wynnes to move out of Maryland...this may be an unwelcome outcome.

Here, it is easy to see that businesses, whether run as sole proprietorships or as S-corporations, have an incentive to move their operations out-of-state if they conduct business interstate (as opposed to purely intrastate). Thus, as each group clearly constitutes an interstate market, this denial of a tax credit affects most interstate businesses operating in or involved with investors in Maryland.

3. TAX SCHEME EFFECTS MORE THAN LOCAL INTERESTS AND DOES TREAT KEY ECONOMIC INTERESTS DIFFERENTIALLY

The Comptroller further argues that the "county income tax" imposed by the state on residents' out-of-state income and the corresponding lack of a tax credit impacts mainly local interest and does not treat economic interests differently, and therefore should be upheld. The Comptroller stresses throughout his briefs

that the local income tax is necessary to provide for "the fire, police, public works, and other services funded through, among other streams of revenue, the local income tax," a legitimate local interest. If this was the only part of the analysis, *i.e.*, a tax only needed to affect a legitimate local interest, it is likely that no statute would ever be struck down as violating the Commerce Clause. While the "county income tax" clearly does provide for a legitimate interest, it still must not treat economic interests differentially depending upon an interstate element. Here, effectively this credit procedure does treat interstate economic interests differently. By not offsetting out-of-state income taxes paid, residents or economic interests generating a significant portion of their income out-of-state will be subjected to higher effective taxes. That is, the denial of the credit, which layers "county income tax" on top of a Virginia or Pennsylvania income tax if earned in those states, will necessarily result in a higher (and differential) effective tax rate for these taxpayers.

4. THE INCOME TAXES AND CREDITS AT ISSUE HEREIN ARE NOT PURELY LOCAL SO THEY AFFECT INTERSTATE COMMERCE:

While many cases have previously held that "local" or non-state levied taxes can and do affect interstate commerce, this Court need not even determine here whether such a "local" tax can implicate interstate commerce. *See, e.g.*, *Philadelphia Eagles Football Club v. City of Phila.*, 823 A.2d 108 (Pa. 2003) (where a city gross receipts tax was found unconstitutional under the Commerce Clause); *Avanade, Inc. v. City of Seattle*, 211

P.3d 476 (Wash. Ct. App. 2009) (city business and occupations tax deemed unconstitutional). This is because, in *Frey*, the Court of Appeals already explained that for purposes of constitutional analysis the "county income tax" is a state tax, i.e., a component thereof and not a "local" tax. *Frey*, 965 A.2d at 945 (distinguishing constitutional question in that case from statutory construction issue in *Blanton* and concluding also that, were the "county income tax" under TG 10-106 not a state tax, the SNRT would be facially discriminatory). This is because the tax is collected and imposed by the state, is commingled with other taxes collected by the state, and goes to a government in the state (at one level or another). *Id.* at 945, 956.

It is clear that a state-imposed tax and credit scheme can implicate interstate commerce, as have been decided by the many Supreme Court cases cited. See, *e.g.*, *Amerada Hess Corp. v. New Jersey Dept. of Treas.*, 490 U.S. 66 (1989) (evaluating constitutionality of state deduction procedures related to federal windfall profits tax); *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977) *discussed infra*; *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995) *discussed infra*; *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) (finding West Virginia wholesale gross receipts tax unconstitutional); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) ("intangibles tax" imposed by North Carolina based on value of corporate stock and corporate exposure to income tax unconstitutional).

A. TG § 10-703 is Unconstitutional under the *Complete Auto* Analysis

Since the income tax statute here does, at least, affect interstate commerce, the Court must analyze the statute under the analysis set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

In this seminal case, the Supreme Court dealt with "'the perennial problem of the validity of a state tax for the privilege of carrying on, within a state, certain activities' related to a corporation's operation of an interstate business." *Id.*; *citing Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 101 (1975) (quoting *Memphis Gas Co. v. Stone*, 335 U.S. 80, 85 (1948)). Specifically, the Court addressed whether "Mississippi runs afoul of the Commerce Clause, U.S. Const., Art. I, § 8, cl. 3, when it applies the tax it imposes on 'the privilege of . . . doing business' within the State to appellant's activity in interstate commerce." *Id.* In sustaining the Mississippi tax, the Court explained what is necessary to "sustain[] a tax against Commerce Clause challenge." *Id.* at 279. Specifically, the Supreme Court in *Complete Auto* examined "not the formal language of the tax statute but rather its practical effect" to ensure that it was "[1] applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, [4] and is fairly related to the services provided by the State. *Id.* Precedent following *Complete Auto* indicates that each and every element of the test must be satisfied in order not to violate the Commerce Clause. *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988), *citing Wardair Canada Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986).

While the nexus requirements of the Due Process Clause and the Commerce Clause are not exactly the same, this Court does not address the issue of whether Maryland has and the income taxed has "substantial nexus." *See Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992) (stating that "the 'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause"); *also see Tyler Pipe Indus., Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 250-51 (1987) (finding "crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales").

Furthermore, it not necessary for this Court to determine whether or not the tax it issue is "fairly related" to services provided, although it likely is. This Court instead relies on the second and third prongs of the *Complete Auto* analysis in making its decision in this case. This Court holds the income tax statute, as applied to individuals and businesses engaging in multi-state business, is not "fairly apportioned" and discriminates against interstate commerce and thus fails to satisfy the Commerce Clause.

1. "FAIR APPORTIONMENT" PRONG OF *COMPLETE AUTO*

The second prong of the *Complete Auto* analysis requires that a state tax be "fairly apportioned." 430 U.S. at 279. As interpreted in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169, fair apportionment requires "internal consistency — that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed" and also "external consistency — the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." In order to strike down a statute based upon lack of "fair apportionment," the taxpayer must prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted in that State.' "[5] *Id.* at 170 (citations omitted) These two required consistencies for fair apportionment under *Complete Auto*, both internal and external, are lacking in the context of Maryland's income tax statute for reasons explained below.

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[5] For purposes of this opinion, the court will not indulge in a thorough analysis of whether "clear and cogent" evidence has been presented on the unfair apportionment of Maryland's income tax structure (we believe it to be clear). This higher burden of proof is typically necessary in scenarios where value of a non-resident is taxed by a State where the business is conducted. *See, e.g.*, COMAR 03.04.03.08 (dealing with apportionment of income for multistate businesses based on sales, payroll, and property). Here, Maryland's "county income tax" provisions are wholly unapportioned, *i.e.* no attempt to gauge the value of items taxed is made.

2. INTERNAL CONSISTENCY

In order for a state tax to pass muster under the Commerce Clause, the tax must also be "internally consistent." *Id.* That test generally requires a court to determine that if an identical tax statute was in force in every state, interstate commerce would not be at a disadvantage when compared with purely instate commerce. A recent analysis from the Supreme Court in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 185, 115 S.Ct. 1331 (1995), is illustrative:

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with intrastate commerce. A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax.

Therefore, the application of the "internal consistency" doctrine requires examining the following hypothetical in this case: If the Tax - General Article, § 10-101 et seq. (*i.e.*, the entirety of Maryland's income

tax statute), viewed as a whole, was applied across all 50 states, would individuals conducting business in multiple states be put at a disadvantage as compared to those conducting business only in one state? The answer is yes.

In order to demonstrate why this is so, many different parts of the income tax statute must be viewed together. *See Frey v. Comptroller of Treasury*, 965 A.2d 923, 939 (Md. Ct. Spec. App.), *cert. granted*, 972 A.2d 861 (2009) (stating that "a state tax must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme" and "proper analysis must take the whole scheme of taxation into account") (quoting *Maryland v. Louisiana*, 451 U.S. 751, 756 (1981), and *Halliburton Oil Well Cementing Co. v. Reilly*, 373 U.S. 64, 69 (1963). To start, TG § 10-103 provides that:

> Each county shall have a county income tax on the Maryland taxable income of: (1) each resident, other than a fiduciary, who on the last day of the taxable year: (i) is domiciled in the county; or (ii) maintains a principal residence or place of abode in the county.

In ending his analysis here, the Comptroller states that the county tax must stand because a taxpayer can only be domiciled in one place on the last day of the year, and thus only one state will impose a local tax and therefore no double taxation occurs. This analysis, however, does not incorporate other important provisions of this Article, including TG §§ 10-102 and 10-102.1 (regarding imposition of tax for individuals and certain pass-through entities respectively and

which generally impose state income tax on Maryland residents wherever such income is earned), TG §§ 10-106 and 10-106.1 (regarding imposition of county income taxes and special non-resident taxes), and TG § 10-703, the focal point of this entire case. The latter statute provides that:

> *(a) In general* - Except as provided in subsection (b) of this section, a resident may claim a credit only against the State income tax for a taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year.

A previous interpretation of this statute in *Comptroller v. Blanton*, 390 Md. 528 (2006), clearly indicates that TG § 10-703(a) affords a credit against only State income tax, and not against any local income tax liability. Viewed together, and as exemplified by the Petitioner, the income tax scheme in Maryland will usually work a more onerous tax on individuals that generate any income out-of-state, when compared to those generating all of their income in Maryland (and never a less onerous tax). An example shows the practical effect of the income tax statute and its disparate effect[6]:

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[6] The rates reflected in the following hypothetical are gathered from 2009 and assume that the local/county tax rate is that of Howard County for 2009.

Maryland Resident with Only In-State Income Assuming State Has Same Tax Rate as MD

1000 Widgets @ $1 = $1000 revenue

MD State tax (6.25% of $1000) = $62.50

MD County tax (3.2% of $1000) = $32.00

MD tax liability = $94.50

State **X** State tax (6.25% of $1000) = $62.50

State **X** County tax (1.25% of $1000) = $12.50

Maryland Resident Only Out-of-State Income (State X)

1000 Widgets @ $1 = 1000 revenue

MD State tax (6.25% of $1000) = $62.50

MD County tax (3.20% of $1000) = $32.00

MD tax liability (pre-credit) = $94.50

State **X** tax liability = + 75.00

Taxpayer's total tax liability (pre-credit) = $169.50

Tax credits (limited to MD state tax) = - 62.50

Final Combined tax liability Only Out-of-State Income (State **X**)= $107.00

In essence, since Maryland systematically excludes credits against the local income tax portion of the taxpayer's liability, Maryland residents will necessarily pay more in total tax liability (i.e., the tax liability owed Maryland and other states) if a large enough percentage of their income is derived out-of-state, assuming all states have an identical tax framework to Maryland (see example above illustrating this). This will happen regardless of whether the taxpayer earns their income personally, or whether such income is derived from distributions made by an S-corporation. Since Maryland's tax structure, when applied hypothetically to all states, results in differing tax liability depending on whether or not the income is earned in-state or out-of-state, it fails the "internal consistency" test as set forth in *Jefferson Lines*.

While case law mainly depicts statutes failing for lack of internal consistency because of a lack of *any* credit for cross-jurisdictional taxation, the same analysis carried out in those cases holds for Maryland's partial credit scheme as well.[7] As pointed out by the Alabama Supreme Court in *M & A Assocs., Inc. v. City of Irondale*, 723 So. 2d 592 (Ala. 1998), a gross receipts tax that taxed all money earned by locally domiciled businesses, no matter where earned and without providing credits for taxes paid to other jurisdictions

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[7] By partial credit scheme, it should be noted that this refers to Maryland's crediting against state taxes and not local taxes, even though both are state taxes for constitutional purposes. *See Frey*. This is not meant to imply that Maryland gives a credit towards local taxes owing to out-of-state generated income, as the Code does not provide for this.

and also taxed money earned by businesses domiciled elsewhere was unconstitutional. *Id.* at 593. Applying the "internal consistency" analysis, the court reasoned that, if every state where a business operated sought to impose the same tax on gross receipts, one sale would be subjected to multiple layers of tax (one from each jurisdiction) purely based upon the fact that business was performed there, regardless of amount. *Id.* at 598. The court went on to say that a law "that creates the possibility of such multiple taxation does not satisfy the 'fair apportionment' part of the *Complete Auto Transit* test." *Id*; *accord, e.g. Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987) (applying internal consistency analysis to Washington state taxes); *Northwest Energetic Servs., LLC v. Franchise Tax Bd.*, 159 Cal. App. 4th 841, 862 (2008) (striking down LLC tax as internally inconsistent because "LLC engaging in business in multiple states" would face multiple taxation while "LLC operating only in one state would pay the [tax] only once"). As the example shows, some amount of total tax due under Maryland's income tax scheme will be duplicated without providing any credit against "county income tax." For this reason, TG 10-703(a), as currently interpreted by the Tax Court below, cannot stand for lack of "internal consistency."

3. EXTERNAL CONSISTENCY

Another requirement to pass constitutional muster under the dormant Commerce Clause is "external consistency." *Container Corp.*, 463 U.S. at 169. Generally speaking, external consistency asks "whether the State has taxed only that portion of the revenues from the interstate activity which reasonably

reflects the in-state component of the activity being taxed." *Id.* at 169-170. Thus, the Court looks to the activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity. A brief overview of judicial precedent setting out this test is useful in explaining this Court's finding that the local tax procedure with its lack of an appropriate credit mechanism is not externally consistent as interpreted by the Comptroller.

The doctrine was explored rather comprehensively in *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995), a case that dealt with the constitutionality of state sales tax that taxed the entire value of a fare for bus travel from Oklahoma to another state. The Supreme Court stated that while "internal consistency" deals with the threat of multiple taxation from literally identical statutes, external consistency instead focuses upon the "economic justification for the State's claim upon the value taxed" to discover whether the tax "reaches beyond the portion of value that is fairly attributable to economic activity within the taxing State" and could lead to "impermissible overreaching" under the Commerce Clause. *Id.* at 185.

While *Jefferson Lines* spoke primarily about the external consistency of sales taxes and credits, this Court examined and cited a host of cases involving disputes on state income taxes, such as *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), *Container Corp.*, 463 U.S. at 170, and *Central Greyhound*, 334 U.S. at 663. These cases dealt with fair "apportionment" of corporate income by attributing to the taxing state income from the corporation "in the proportion which the gross sales made within the state bear to the total

gross sales," *Moorman* at 270, on a formula "based, in equal parts, on the proportion of [such] business' total payroll, property, and sales which are located in the taxing State," *Container Corp.* at 170, and for a bus line, the "gross receipts...limited to that portion reflecting miles traveled within the taxing jurisdiction." *Central Greyhound* at 663. In each of these instances, the Supreme Court upheld the statute because it was at least intended to reasonably allocate taxes based upon income attributable to the taxing state. Maryland is, in fact, no different in this respect. As to non-resident multi-state income-generating individuals and corporations, Maryland law attempts to tax only the fair share of income by limiting the tax base to items of income generated in Maryland, according to an apportionment formula. *COMAR*, 03.04.03.08. However, while Maryland is required to address risks of external consistency in the context of non-residents generating income within state lines, it must also address risks of multiple taxation in the reverse situation: Maryland residents earning income outside of Maryland's borders.

In this respect, the Maryland statute fails. The Supreme Court dictated, that as an alternative to apportionment and allocation schemes, a state may meet its burden under external consistency by permitting a credit to taxes for residents against out-of-state sourced income. *Goldberg v. Sweet*, 488 U.S. 252, 264 (1989) (*citing D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 32 (1988)). However, under this alternative method to satisfy external consistency, the state still must try to adequately avoid the problems of multiple taxation. This is not satisfied by merely providing a credit against a portion of taxes paid to other states; it

must at least attempt to give a credit against all taxes on income sourced to other states.

This principle is illustrated in cases such as *Philadelphia Eagles Football Club v. City of Philadelphia*, 823 A.2d 108 (2003) and *Avanade, Inc. v. City of Seattle*, 211 P.3d 476 (Wash. Ct. App. 2009). In that first case the city of Philadelphia imposed a gross receipts tax on all income earned by the football team, even though only half the games were played within the city limits. *Philadelphia Eagles* at 115-16. The Supreme Court of Pennsylvania, in overturning the decision of the lower court, held that, while proceeds from the media contracts were correctly included in calculating the gross receipts tax due from the organization, external consistency under the Commerce Clause did not permit the city to include "receipts attributable to the one out of every two football games that were played by the Eagles Team in, and telecast from, other taxing jurisdictions." *Id.* at 135. Such unapportioned taxation would lead to the unconstitutional "risk of being subjected to multiple taxation." *Id.* at 132-33. The Court also explained that under precedent set in *Central Greyhound*, 334 U.S. 653 (1948), gross receipts taxes, as a form of income tax and not a retail sales tax, were subject to apportionment measures (unlike retail sales which could be on an apportioned basis due to their "local" subject matter). The recognition of a requirement to apportion income has been reiterated in numerous cases. *See, e.g. Polychrome Int'l Corp. v. Krigger*, 5 F. 3d 1522, 1540 (3d Cir. 1993) ("any tax – including one imposed on, or measured by, gross receipts from interstate and foreign commerce–must be apportioned to reflect only that business activity attributable to

intrastate commerce"); *City of Winchester v. American Woodmark Corp.*, 252 Va. 98, 471 S.E.2d 495, 495, 498 (1996) (recognizing taxpayers' right to apportionment of a gross receipts tax); *Southern Pacific Transp. Co. v. Arizona, Dep't of Revenue*, 202 Ariz. 326, 44 P.3d 1006, 1014 (2002) ("In our view, *Jefferson Lines* compels the view that gross receipts taxes . . . must be apportioned to comply with the . . . Commerce Clause."); *see generally*, Hellerstein & Hellerstein, *State Taxation*, ¶ 18.08[5].

Applying this analysis to the case at bar, since Maryland levies tax on all income of its residents and attempts to limit such tax to its "fair share" by providing a credit against out-of-state income taxes paid, Maryland must at least have a credit procedure which gives a credit against income allocable to other states. While the statute need not be perfectly symmetrical with other states' formulas (and some minimal double taxation may result), Maryland may not constitutionally deny a reasonably apportioned credit against local tax, and thus double tax, income clearly emanating from out-of-state sources.

In *Avanade*, the Court of Appeals of Washington dealt with the constitutionality of Seattle's business and occupation tax (B&O tax). 211 P.3d at 476. The court there held the statute unconstitutional under the Commerce Clause because the "manner in which it utilized cost apportionment improperly attributed revenue to Seattle that should have been attributed elsewhere." *Id.* at 477. While the city did attempt to meet its constitutional burden regarding "fair apportionment" by applying a formula to determine a taxable base attributable to the city, the court held that

it unacceptable because it "failed to allocate any revenue for on-site work in states without physical Avanade offices to those states, notwithstanding that the Avanade consultants at issue were based in those states, and notwithstanding that the work was performed in those states, exclusively for businesses also based in those states." *Id.* at 482. In so holding, the court relied upon precedent from *Gen. Motors Corp. v. Wash.*, 377 U.S. 436, 440, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964), and *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987).

As these cases indicate, merely because the tax at issue is a "local income tax" does not permit Maryland to deny taxpayer a credit against this tax for income taxes paid to other states. Taxation of a "fair share" of value, at least for income-based taxes, by a state or municipality for external consistency purposes does not look to whether the tax is levied for a particular purpose or governing body. It merely asks whether a taxing jurisdiction has overstepped its bounds and is reaching more than its share (resulting in multiple taxation), by not conceding primary authority to tax to the state where the activity was performed. It was clear in *Philadelphia Eagles* that a city based income did not exempt its tax scheme from meeting the external consistency analytical standard; the same line of reasoning used in that case requires finding a lack of external consistency as to Maryland due to neither an appropriate apportionment scheme or credit procedure. Thus, based on the foregoing analysis, this Court reaches the same conclusion as those in the aforementioned case just cited, which will require the same result.

4. DISCRIMINATION AGAINST INTERSTATE COMMERCE

The third prong of the *Complete Auto* test requires that in order for a tax statute to be constitutional under the dormant Commerce Clause it must not "discriminate against interstate commerce." 430 U.S. at 279. Various cases decided by the Supreme Court have held that a state tax may not "unjustifiably... discriminate against or burden the interstate flow of articles of commerce," *Oregon Waste Sys., Inc. v. Dept. of Envtl. Quality*, 511 U.S. 93, 98 (1994), nor may it "discriminate between transactions on the basis of some interstate element." *Armco*, 467 U.S. at 642 (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 332 n. 12 (1977).

While a tax that imposes differential treatment on its face is "virtually per se invalid" (*Frey*, 965 A.2d at 936 (quoting *Oregon Waste*, 511 U.S. at 99), "[u]nder the anti-discrimination component of the *Complete Auto* test, a tax [also] discriminates against interstate commerce if it is 'facially discriminatory, has a discriminatory intent, *or* has the effect of unduly burdening interstate commerce.'" *Sprint Commc'ns Co. v. Kelly*, 642 A.2d 106, 114 (D.D. 1994) (quoting *Amerada Hess Corp. v. Division of Taxation*, 490 U.S. 66, 75 (1989)).

As the Petitioner correctly states, discriminatory effect may stem not only from the tax standing alone, but may arise from its interaction with other states' taxes based on the same value. *See Barringer v. Griffes*, 1 F.3d 1331 (2d Cir. 1993) (finding a "use tax" on cars unconstitutional because when taken together with

sales taxes imposed by other states, the statute had the "secondary effect[]" of foisting a larger tax burden on vehicles brought in from outside Vermont and thus "creat[ing] a bias towards in-state purchases). Many other cases have struck down taxes on the basis of discrimination if they either placed multiple tax burdens on activities or if they tended to discourage participation in multi-state business. *See Fulton Corp. v. Faulker*, 516 U.S. 325 (1996) (finding a North Carolina tax on stock holdings discriminatory because it penalized stock owners for owning stock in companies that operated in more than one state) The *Fulton Corp.* case is analogous to the case at bar. In striking down the statute at issue, the Supreme Court stated: "a regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents." 516 U.S. at 333. Here, the credit provisions of TG § 10-703 work to tax individuals or pass-through entities more extensively when they actually participate in interstate commerce as well (by generating income out-of-state). The resulting effect of these incrementally higher net taxes on multi-state business operations puts multistate domestic entities at a disadvantage compared to purely intrastate domestic entities and thus "tend[s] to discourage domestic corporations [and individuals] from plying their trades in interstate commerce." *Id*; *accord Camps Newfound / Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 576 (1997) (striking down as discriminatory a Maine tax that "encourage[d] affected entities to limit their out-of-state clientele"), *AT&T Corp. v. Mississippi State Tax Comm'n*, 2006 WL 2506366, at *3 (Miss. Ch. Ct. June 12, 2006) (where a tax exempting from a

company's gross income only those dividends received from in-state affiliates was found discriminatory because it "discourages S-corporations from choosing to locate their operations outside Mississippi"), and *Chapman v. Comm' r of Revenue*, 651 N.W.2d 825, 834 (Minn. Sup. Ct. 2002) (striking down statute allowing individuals to deduct contributions to local charities but not out-of-state charities).

As the Supreme Court has signified before, merely because taxes akin to the "county income tax" and corresponding credit provisions appear nondiscriminatory "does not save it from invalidation." *Tyler Pipe*, 483 U.S. at 238. Since Maryland's income tax statute "ha[s] the effect" of treating businesses differently depending upon the percentage of income generated in Maryland, the statute and its lack of giving any credit for "county income tax" when such income is generated and taxed out-of-state is unconstitutional, *quoting Westinghouse Elec. Corp v. Tully*, 466 U.S. 388, 400 (1984).

5. OTHER POLICY REASONS

By way of illustration to demonstrate the faulty logic of the ruling of the Tax Court below in upholding Maryland's lack of full credit tax scheme, if the county income tax was not subject to the same "double taxation" considerations of the Commerce Clause (*i.e.*, no tax credit was required), there would be nothing to prohibit Maryland from collecting all State income taxes as "county income taxes" to avoid the necessary credit mechanism. This perverted result, which takes the current scheme to its extreme, would clearly burden interstate commerce.

The county income tax, although, *arguendo*, generally generating revenue to support services provided to Maryland and/or Howard County residents, does not aid income-generating activities of those residents occurring out-of-state. As the sourcing rules indicate (*i.e.*, primary taxable source of income is the place where generated), this income is more clearly related to the services provided by the states where the income is generated. In order not to violate the dormant Commerce Clause strictures discussed herein, Maryland, or Howard County, if either seeks to impose taxes in order to provide for local services, needs to rely on the local tax base in Howard County, *i.e.*, income taxes on income earned, sales tax based upon sales occurring, property taxes on property located there, etc. By way of further illustration, Maryland and its counties (and the services they provide) have little more, if any, connection to a Howard County resident's services actually performed in Virginia than they do to a sale of Delaware beach property the resident owns, or of his business sold in Ohio. However, by virtue of residence in Maryland, the Comptroller asserts that all of these transactions could be fully subject to "county income tax" without regard for any credit against the tax imposed by the other states.

If Maryland was not required to provide credits against "local income tax," the end result, as the Comptroller suggests, would likely be that many Marylanders with business across state lines would quickly become ex-Marylanders. Projecting this lack of credit mechanism further, there is no reason to believe that individuals, who conduct business primarily out-of-state, would live in Maryland would willingly continue to be subjected to a 3.2% "county income tax"

merely for the sake of living there (when the county has nothing to do with the generation of this income and they are likely already paying a similar tax to some other out-of-state county). Many of these high income earners would clearly prefer to live out of state where they are only taxed once. Alternatively, multi-state business entities would either reorganize their operations, and solely operate within state lines or turn away from Maryland altogether. Either path would lead them away from Maryland's double tax system and would also cause a drop in Maryland's tax revenue from other channels.

This Court finds the Comptroller wrong in his assertion that individuals like the Wynnes, as only minor shareholders, cannot affect the operations of a multi-billion dollar organization. In the aggregate, seemingly minor changes in income tax rates and other policies affecting businesses can have a great impact on the location of their businesses. Constitutional jurisprudence holds that there is no "de minimis" defense to the charge of discriminatory taxation under dormant commerce clause.

Furthermore, while revenue generated from "county income taxes" imposed on individuals like the Wynnes may be substantial, it likely pales in comparison to the lost revenue from the tax imposed on the income of hundreds and thousands of those employed by Maxim in Maryland (which might be lost if Maxim moves its operations under the direction of the Wynnes).

Building off this last point, if this situation was allowed to stand, investment by Marylanders in S-corporations would likely be stifled. Since Maryland

investors in S-corporations are essentially doubled taxed via "county income taxes," they face a higher cost of investment as compared to individuals in other states investing in multi-state S-corporations are individuals in Maryland investing in S-corporations doing business purely in-state. This effect could curb much investment in such corporations and could steer corporate operations (and jobs) away from Maryland.

The correct way to achieve the level of taxation to provide for county and state services to meet constitutional standards is to adjust and/or apply the tax code and tax rates, which imposes two levels of tax, by providing complete or fair and reasonable credits for "the county tax" component on certain activities.

It should also be noted that while an S-corporation is required to compensate its shareholder/managers adequately with salary (so they do not avoid paying employment taxes like FICA/Social Security which are not taxes imposed on distributions), it is often hard to distinguish between the income from S-corporations due to salary and distributions. To set forth a categorical rule that S-corporation distributions were passive would almost definitely influence shareholder/managers to arbitrarily alter these two types of income so as to not be taxed at all by Maryland or have all income classified as salary (and entitled to a credit). This is another reason why the Comptroller's attempt to classify S-corporation distributions as "passive" makes no practical sense.

Thus, based on the forgoing analysis, the tax scheme in question herein is found to have an adverse

effect on interstate commerce, so as to implicate the "dormant" Commerce Clause.

IV. CONCLUSIONARY DISCUSSION & RULINGS

By way of summarizing the highlights, this Court notes the Comptroller essentially argues that the income in question, despite being Subchapter S income, is passive in nature, that its actual source for valuation purposes is really the residency of the recipient Petitioners and not the out-of-state sources of Maxim S-corporate income, as the Petitioners argue. He particularly notes that, being Howard County residents on the last day of the taxable year, the Petitioners are subject to "the local tax." Thus, because of the income's alleged "passive" rather than "pass-through" nature, the Comptroller posits that Petitioners should not be given a credit for out-of-state taxes paid against the county portion of the Maryland tax, *i.e.*, that portion being arguably related more to the residency of the Petitioners to compensate the state government for police and fire protection services, *etc.*, they receive at their residence in Howard County. He bases that argument on the case law cited below that allows for a state to retain or arguably allocate a reasonable portion of its tax towards the support of such services as just mentioned.

Specifically he further argues all of those taxes on income of Maxim corporation that Petitioners argue is sourced out-of-state and upon which out-of-state state taxes were paid to those jurisdictions, should not be credited against the county portion of the Maryland tax as that percentage represents a reasonably

proportionate amount to cover those services rendered particularly by the state and/or the county of the Petitioners' residency. The Petitioners do not necessarily contest that latter point as to proportionality of services. That Office also argues that, since the mechanism we are dealing with here is a credit and not a tax itself and, thus, is more indirect in nature, it should not be seen as having a significant negative impact on interstate commerce.

This Court has considered all those arguments; while most have some merit at first blush, they do not withstand further constitutional analysis. Having found that the income at issue here is "pass-through" sub S-corporation income on which tax was paid to other states and understanding that the Petitioners and the Comptroller both concede that the tax rates set by Howard County is not directly based on any formula for revenue generation/reimbursement of Howard County or the state for police, fire services, *etc.*, rendered by either to either government entity or on behalf of each other there, this Court simply comments that latter reimbursement/attribution aspect has only a neutral effect in weighing any consideration that the State is free not to credit the "county portion' of the tax to payment of out of state taxes.

Nevertheless, based on the record before it, this Court finds that "county tax" herein and its rate are significant and the county tax at its 3.2% rate has not been actually shown to be reasonably close to proportionate the costs to support any government services received by the Petitioners in their resident Maryland county of Howard.

This Court certainly understands that a credit is more indirect in nature than a direct taxes paid on some economic activity or value. It, nevertheless, finds that, because "the county portion" cannot be directly or proportionately related, by formula or otherwise, to support legitimate services that the county or state had rendered to the Petitioners, the State is not justified in withholding most of the credit for it. It particularly notes that these Petitioners have paid a significant amount of tax to the State of Maryland based on income sourced in-state, *etc.*, for which they obviously would not have received any credit. Also, it finds they have paid at least an adequate or proportionate share of their state income taxes which would be generally attributable to support or compensate for to those related government services. In addition, understanding as Hellerstein points out that the credit mechanism is one which is used extensively by various states to balance the effect of their state tax schemes so as not to impact negatively on interstate commerce, this Court finds that Maryland has failed to do so. That failure to grant a fairly apportioned credit for the county portion of the state taxes paid for out-of-state taxes on income sourced out-of-state is not so insignificant nor is it generically so indirect as to not have a negative impact on interstate commerce.

The Comptroller argues, based on the record herein, that the Wynnes have not shown by any clear and cogent evidence that the credit scheme in question sufficiently affects or is connected to Interstate Commerce as arguably required by the three cases they cite: *Fulton Corporation v. Faulkner*, 516 U.S. 325 (1996); *Camps Newfound/Owatonna, Inc. v. Town of*

Harrison, 520 U.S. 564 (1997) and *Chapman v. Commissioner*, 651 N.W.2d 825 (Minn. 2002).

In analyzing that argument, this Court notes, first however, that *Chapman* holds that, although it is true that the Commerce Clause protects markets and participants in markets rather than taxpayers as such, a state regulation, imposed on individual taxpayers that does not directly tax a commercial activity or organization, can implicate the Commerce Clause. U.S.C.A. Const. Art. 1, §8, cl.3; M.S.A. §290.21, subd. 3(b) (2000). To withstand Commerce Clause scrutiny, a state tax scheme as a whole must (1) be applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the state. U.S.C.A. Const. Art. 1, §8, cl.3. Under the "dormant" Commerce Clause, a state may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within state. Maryland's scheme does. Constitutional jurisprudence holds that there is no "de minimis" defense to the charge of discriminatory taxation under dormant commerce clause.

Next, contrary to the Comptroller's position, this Court finds the logic and precedential authority set out by the U. S. Supreme Court in *Fulton* applies to the situation herein. The *Fulton* decision involved the petitioner corporation, which owned stock in other out-of-state corporations, disputing the constitutionality of an intangibles tax levied on corporate stock owned by residents of the state by the respondent state authority. The corporation contended that the scheme based on the taxable percentage deduction violated the

Commerce Clause by discriminating against interstate commerce. It claimed entitlement to a refund of the tax it had paid and attorney fees. The *Fulton* holding is summarized as follows:

> The Supreme Court determined that the scheme was facially discriminatory against shareholders in out-of-state corporations by forcing them to pay tax on a higher percentage of share value than shareholders of corporations operating solely in the state. It rejected the state's contention that the tax amounted to a valid compensating tax for availing themselves of the state's capital market. It held that there was no proof of any in-state activity or benefit to justify the compensatory levy and that the state could not treat general revenue measures, such as the capital market, as relevant interstate burdens for purposes of the compensatory tax doctrine.
>
> It further held there are three conditions necessary for a valid compensatory tax which this Court finds to be analogously applicable to the tax credit scheme involved herein. First, a state must, as a threshold matter, identify the interstate tax burden for which the State is attempting to compensate. Second, the tax on interstate commerce must be shown roughly to approximate the amount of the tax on intrastate commerce. Finally, the events on which the interstate and intrastate taxes are imposed must be substantially equivalent; that is, they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other.

Further relying on Oregon *Waste Systems, Inc. v. Department of Environmental Quality of Ore.*, 511 U.S. 99, the Supreme Court in *Fulton* held at 332 - 333:

> We have also recognized, however, that a facially discriminatory tax may still survive Commerce Clause scrutiny if it is a truly " 'compensatory tax' designed simply to make interstate commerce bear a burden already borne by intrastate commerce."

and ...

> First, "a State must, as a threshold matter, 'identify... the [intrastate tax] burden for which the State is attempting to compensate.' " *Oregon Waste*, *supra*, at 103 (quoting *Maryland v. Louisiana*, 451 U.S. 725, 758, 68 L.Ed. 2d 576, 101 S. Ct. 2114 (1981)). Second, the tax on interstate commerce must be shown roughly to approximate – but not exceed – the amount of the tax on intrastate commerce." *Oregon Waste*, 511 U.S. at 103. "Finally, the events on which the interstate and intrastate taxes are imposed must be 'substantially equivalent'; that is, they must be sufficiently similar in substance to serve as mutually exclusive 'proxies' for each other." *Ibid.* (quoting *Armco Inc. v. Hardesty*, *supra*, at 643).

Thus, this Court, having ruled the Maryland tax scheme in question to be discriminatory against Maryland resident shareholders of S-corporations by disproportionally taxing income streams sourced out-of-state and, thus, adversely effecting interstate commerce, rules Maryland has failed to meet its burden of proof and persuasion required by *Fulton* and *Oregon Waste Systems, Inc., inter alia.* Those burdens include a showing its tax credit scheme meets the three conditions mentioned above. Thus, it is Maryland, and not the Wynnes as argued by the Comptroller, which has the burden of proof as to meeting those three conditions. It has failed to meet them as well as failed to show that interstate commerce is not affected by its tax credit scheme.

In addition, this Court rules, under the required internal consistency test under *Oklahoma Tax Commission v. Jefferson Lines, Inc.* & the *Complete Auto* cases, that the Wynnes do not have to identify or show either that similarly situated persons with whom they compete. Though somewhat more indirect in nature than a compensatory or an intangibles tax because of the inherent character of any tax credit scheme, there are identifiable interstate activities and markets being affected here. First of all, the Wynnes' income stream in question here was sourced out-of-state and subject to out-of-state taxes. Thus, there is by play between an out-of-state corporation and income streams generated by it and taxed out-of-state and a Maryland tax credit scheme related to that income stream received by Maryland residents.

Also, interstate economic activity is involved because the income streams ultimately involved and

affected by lack of a effect of allowing double-taxation in those states and, as such, by definition, would adversely affect Interstate Commerce.

Also, while the Comptroller argues that a Maryland resident has to pick up the pro-rated share of distribution from investments and S-corporations by virtue of having to report their federal adjusted gross state income when reporting income for state income tax purposes, this Court does not find that to have significance to the resolution of the instant case, *e.g.*, the out-of-state tax would obviously not have been accounted for or credited in that calculation. In fact, that is exactly what is at issue herein. Note you do not get credit on federal return for the payment of state income taxes. Also, again, this Court has ruled that the income stream in question here is not passive as the Comptroller argues, but is pass-through, as defined under Federal tax law which interpretation Maryland, by its own statute, is required to follow.

This Court finds that the record is sufficient to indicate that the failure of Maryland to allow a fair and reasonably apportioned credit for "the county tax" adversely affects Interstate Commerce. While it may not directly affect a product or market, it would have the effect of discouraging other Maryland residents from investing in corporations that generate income out-of-state.

V. CONCLUSION

For all the reasons stated herein and just summarized, the Court finds in conclusion that the failure to provide a credit for the county portion of the

state taxes paid on out-of-state income violates the negative Commerce Clause of the United States Constitution. The Court makes this finding of unconstitutionality noting particularly that this county portion of the Maryland state income tax is not a county or city tax levied by those lower tiers of government but then collected for them for the sake of convenience by the State, when a resident files his or her Maryland state income tax return. It is a component of a Maryland State imposed tax. Based on clear statements in Maryland case law cited above in *Blanton*, etc., "the county portion" is simply a portion of the State income tax that has a different mechanism for arriving at its rate to form one of two components of one ultimate Maryland State income tax.

This finding of unconstitutionality of Md. Code, TG § 10-703(a) credit procedure as interpreted by the Tax Court below is made based on clear and logical evidence on the record herein and on application of the stringent standards for making such a ruling pursuant to *Livingston v. Maryland*, *192* Md. App. 553, 568 (2010) and *Fell v. Maryland*, 42 Md. 71, 77 (1875) as well as *Aggregates Ass'n v. Maryland*, 337 Md. 658, 655 A.2d 886, *cert. denied sub nom. Genstar Stone Prod.* Co. *v. Maryland*, 514 U.S. 1111 (1995) & *Department of Public Safety & Correctional Services v. Demby*, 390 Md. 580, 890 A.2d 310 (2006). It is also made, after given the appropriate degree of deference and weight accorded to the position of the administrative agency below and the Tax Court and their legal interpretation and application of the statutory tax scheme in question herein, which the Comptroller Office administers and which the Tax Court ruled on below. This Court makes this ruling understand it may have a detrimental effect

on the ability of the State to collect tax revenue during times of economic downturn and diminished tax collection. But nevertheless, after such consideration, this Court has ruled the Tax Court was erroneous as a matter of law. As the U.S. Supreme Court recently ruled on June 16 in *Bond v. United States*, 564 U.S. __ (2011) (Slip Opinion):

> An individual has a direct interest in objecting to laws that upset the constitutional balance between the National Government and the States when the enforcement of those laws causes injury that is concrete, particular and redressable.

Each of those last three descriptors has application to this case.

V. FINAL RULING

For all the reasons stated herein, the Tax Court's interpretation of TG Art. §10-703 (a) that "... a resident may claim a credit only for the State income tax for the taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year "as only applying to "the state component thereof and not the "county tax" component is in error, as a matter of constitutional law. That is so because the failure of the Maryland Comptroller and Tax Court applying Maryland statutory law, specifically TG Art. §10-703(a), Md. Code to allow for a credit of the entire portion of the applicable subject State income tax calculated to be paid by the Petitioners including the "county tax" calculated at the Howard County rate or a fair and

reasonable apportionment of the latter against the out-of-state income taxes paid by the Petitioners, on income as identified in the record herein is found to be unconstitutional as it violates the "dormant" Commerce Clause of the U. S. Constitution, Article 1, Section 8, Clause 3, (U.S.C.A. §8, cl.3).

Thus, the judgment of the Tax Court is reversed and this case is remanded to it for further factual considerations and final ruling allowing for the proper redress, an appropriate credit for out-of State income taxes paid on the income earned out-of-state including the "pass thru" income received by the Petitioners from Maxim S-corporation consistent with the legal rulings set forth herein, with the right of the Tax Court to remand to the Comptroller's Office for further proceedings, if deemed necessary and appropriate.

June 28, 2011 /s/ Louis A. Becker, Judge
Date Louis A. Becker

CC: Christopher T. Handman, Esquire
Brian L. Oliner, Asst. Atty General

IN THE CIRCUIT COURT
FOR HOWARD COUNTY

CASE #: 13-C-10-80987

MARYLAND TAX COURT

Appeal #: 08-IN-00-0791

[Filed June 29, 2011]

BRIAN WYNNE, *et al.*	)
	)
Petitioners	)
	)
FOR JUDICIAL REVIEW OF A DECISION OF THE MARYLAND TAX COURT	)
	)
And	)
	)
MARYLAND STATE COMPTROLLER OF THE TREASURY	)
	)
Respondents	)
	)

ORDER

Upon consideration of the record below before the Tax Court being the Agreed upon Statement of Facts, testimony, evidence including documentary exhibits, and arguments of counsel;

Upon appropriate deference, having been given to the decision of the Comptroller and Tax Court along with the weighing, *de novo*, of the arguments of the parties in the Memoranda filed and presented orally on judicial review;

For all the reasons stated in the attached Memorandum, causing this Court to conclude that the Tax Court's interpretation of TG Art. §10-703(a) Md. Code, that "...a resident may claim a credit only for the State income tax for the taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year "as only allowing a credit for "the state component thereof and not the "county tax" component, was erroneous as a matter of law;

And, further causing this Court to conclude that the failure of the Maryland Comptroller and Tax Court applying the law, specifically TG Art. §10-703(a), Md. Code to allow for a credit of the entire portion of the applicable subject State income tax calculated to be paid by the Petitioners including the "county tax" calculated at the Howard County rate or a fair and reasonable apportionment of the latter against the out-of-state income taxes paid to other states by the Petitioners, on income as identified in the record herein including the attached Memorandum;

And further causing this Court to rule said section of the Tax — General Article, Md. Code as applied by the Maryland Tax Court as violative of the "dormant" Commerce Clause of the U. S. Constitution, Article 1, Section 8, Clause 3, (U.S.C.A. §8, cl.3), and, thus, unconstitutional,

Therefore, it is this 28th day of June, 2011 in the Circuit Court of Howard County,

ORDERED that the judgment of the Tax Court be and is hereby reversed and this case is remanded to it for further factual considerations and final ruling allowing for an appropriate credit for out-of State income taxes paid on the income earned out-of-state including the "pass thru" income received by the Petitioners from Maxim S corporation consistent with the legal rulings set forth herein, with the right of the Tax Court to remand to the Comptroller's Office for further proceedings, if it is deemed necessary and appropriate.

/s/ Louis A Becker, Judge
Louis A. Becker

CC: Christopher T. Handman, Esquire
Brian L. Oliner, Atty. General's Office

APPENDIX D

MARYLAND TAX COURT
301 West Preston Street, Suite 1513
Baltimore, Maryland 21201

MTC No. 08-IN-OO-0791

[Dated December 10, 2009]

BRIAN and KAREN WYNNE	)
	)
- vs -	)
	)
COMPTROLLER OF THE TREASURY	)
	)

Baltimore, Maryland

(Continued Hearing)

BEFORE: HONORABLE STEVEN E. SILBERG

APPEARANCES:

ON BEHALF OF THE PETITIONERS:

ROBERT A. SNYDER, JR., ESQUIRE
MATTHEW F. PENATER, ESQUIRE

ON BEHALF OF THE RESPONDENT:

BRIAN L. OLINER, ESQUIRE

Transcribed by:
Diane E. Smith

[p.2]

CONTINUED HEARING

THE CLERK: Your Honor, the next case is that of Brian and Karen Wynne versus Comptroller of the Treasury. The Tax Court Appeal No. is 08-IN-OO-0791. The Petitioners are represented by Mr. Robert A. Snyder, Jr. and Mr. Matthew F. Penater, while the Comptroller is represented by Brian Oliner. This matter is before the Court on a continued hearing.

JUDGE SILBERG: Good!

MR. OLINER: Good afternoon, Your Honor. Preliminarily, I've given a copy of this to Mr. Snyder, which was your answers -- or the answers, hypothetical, that you requested. Just to explain what we have there: Initially, the first page, which is the one that doesn't have boxes on it, we did that in using the actual tax rates, the 2008 tax rates, which are graduated tax rates. So what we did is, after we saw what the Petitioners had provided the Court using a flat rate, we went and the second page shows our responses using the flat rates that they used, which in fact are the same what they had done in column one, I believe . . .

JUDGE SILBERG: The Maryland tax rates really weren't relevant to what was going on.

MR. OLINER: Which is why I thought, for

[p.3]

comparison sake, you'd want to see that we came up with, at least for the Comptroller's position in this case, the same thing, and that we didn't have any dispute with the numbers that they came up with.

JUDGE SILBERG: You actually agree with their column one?

MR. OLINER: Their column one.

JUDGE SILBERG: Okay.

I guess my first question is, you have columns two and three, which is the point of view that you think should prevail?

MR. SNYDER: We believe it's column two that should prevail.

JUDGE SILBERG: Okay. So . . .

MR. SNYDER: But we did columns two and three because we had in the Petition, as well as in the Pre-Hearing Memo and the Post Hearing Memo both the constitutional argument and the statutory position that we have taken. So and there's a difference in the . . .

JUDGE SILBERG: Okay. If you think column two should prevail, I'm not going to argue with you about it. I'm perfectly happy to forget about column three at least to some extent. And if I'm not incorrect, example two, the only difference is a Sixty-four Thousand Dollar credit towards the end of the column. On example two.

[p.4]

MR. SNYDER: Actually, Your Honor, example two and example . . .

JUDGE SILBERG: Well, let's start with two.

MR. SNYDER: Okay. Example two, that is correct. The only difference between our position and the Comptroller's position would be the Sixty-four Thousand Dollar credit in column two.

JUDGE SILBERG: And example one, if I'm not -- again, the only difference is the Sixty-four Thousand Dollar credit.

MR. SNYDER: Yes, Your Honor.

JUDGE SILBERG: And example three, they're both the same. There is no difference.

MR. SNYDER: That is correct because there is no, under the hypothetical, there is no corporate income tax payable and no income tax payable to Green State, so there's no credit available.

JUDGE SILBERG: Okay. So, I guess, the only real concern then is whether or not a credit should be allowed for the County portion of the taxes paid in Maryland, the Sixty-four Thousand Dollars?

MR. SNYDER: Yes, Your Honor.

JUDGE SILBERG: That was just . . .

MR. OLINER: Did you set that up on purpose, Your Honor?

[p.5]

JUDGE SILBERG: No, I wasn't that clever.

MR. OLINER: Okay.

JUDGE SILBERG: This is not quite like a law school exam when you have clever names, but, okay. I just wanted -- Part of the reason for doing this was just to pin down for sure where you agreed and where you didn't and the ramifications. Okay. I appreciate your extra effort.

And somebody lied about the attendance figures for today.

MR. PENATER: I did, Your Honor. I'm sorry.

JUDGE SILBERG: Yeah. I asked, How many people will likely be here? And he said, Well, I don't know, two or three. Greatly exceeded our expectations.

All right. Any other comments anybody wants to make?

MR. SNYDER: We have none, Your Honor, other than . . .

JUDGE SILBERG: You're ready to hear what I have to say, I think.

MR. SNYDER: Probably.

JUDGE SILBERG: But anything else that you want to say?

MR. OLINER: No, Your Honor.

JUDGE SILBERG: All right. Let me start by, I

[p.6]

want to thank you all for making my life a lot more interesting than it would have been otherwise. People ask me, what kind of cases I like to try? And I said, when I have good attorneys on both sides. Invariably the subject matter becomes a lot more interesting. When you have pro se taxpayers who don't understand the law, the cases are very uninteresting. So much for my point of view.

We'll start with the constitutional argument: I'm not buying it. This case, as to whether or not this statute is unconstitutional for commerce grounds or any other reason, it's been heard before, and the Court of Appeals has affirmed this section in a number of different cases. So I'm not going to overturn the statute

that appears to be there. I really don't see much impact, if any, on Interstate Commerce by the statute itself. The same statute came up in Blanton for credits for taxes paid in North Carolina. Mr. Blanton wanted to get credit towards both the state tax and the county tax and they said, it doesn't work. You don't get the credit, and it's not unconstitutional to do this.

To some extent, I think I probably already answered the other question in front of us as to how this whole statute's going to work. That you will get credit the way the Comptroller asked for it. The way you suggested, the Comptroller was asking that you get credit

[p.7]

for taxes paid to the extent of the Maryland income tax, nothing towards the County surcharge.

All that being behind us, the Order that I need to sign will be to affirm the decision of the Comptroller, and to deny the Petitioners' request for -- I don't know. Procedurally, where are we? What do I need to -- What's the Order going to say to get us there?

MR. OLINER: Upon a review of the stipulated facts and evidence presented and argument of counsel, the Court is affirming the assessment as made by the Comptroller's Office, I believe.

JUDGE SILBERG: Okay. I know -- Well, they filed a petition . . .

MR. OLINER: Right.

JUDGE SILBERG: . . . for an accounting, and I don't know if any of their -- Am I correct? I'm not sure.

It's what you actually filed to get us started.

MR. SNYDER: We filed a petition to, I guess, contest the assessment.

MR. OLINER: Right.

JUDGE SILBERG: Okay. There were some adjustments made to the initial assessment?

MR. OLINER: I believe that that was -- I think it's reflected in the Notice of Final Determination.

[p.8]

MR. SNYDER: I believe that's correct.

MR. OLINER: So it's the assessment that is . . .

JUDGE SILBERG: Okay. I wasn't -- I know there were some changes made, . . .

MR. OLINER: Right.

JUDGE SILBERG: . . . and the Petitioner changed the County of residence at least once.

MR. OLINER: That, and then I think also -- yeah, but the bottom line is whatever changes were made . . .

JUDGE SILBERG: They all have occurred prior or before.

MR. OLINER: . . . are reflected in the Notice of Final Assessment, which is what was appealed to this Court.

JUDGE SILBERG: Okay. All right. Then I will just be signing an Order affirming the Notice of Final Determination that occurred before.

MR. SNYDER: Excuse me, Your Honor.

JUDGE SILBERG: Am I missing something?

MR. SNYDER: We had filed a Motion for a written statement of the grounds for the decision.

JUDGE SILBERG: Well, I just gave you an oral one. If that's not sufficient, then I guess it can be

[p.9]

transcribed. I did remember that.

MR. SNYDER: Thank you.

****

I, DIANE E. SMITH, a Notary Public in and for the State of Maryland, City of Baltimore, do hereby certify that the aforegoing was transcribed by me in a true and accurate manner.

/s/ Diane E. Smith
DIANE E. SMITH
Court Transcriber

APPENDIX E

IN THE MARYLAND TAX COURT

APPEAL NO. 08-IN-OO-0791

[Filed December 29, 2009]

BRIAN & KAREN WYNNE,	)
	)
Petitioners	)
	)
v.	)
	)
COMPTROLLER OF THE TREASURY,	)
	)
Respondent	)
	)

ORDER

This matter having come before the Court for a hearing, and the matter having been heard and considered by the Court, it is this 29th day of Dec., 2009, by the Maryland Tax Court for the reasons stated by the Court, on the record, at the conclusion of the hearing held on December 10, 2009,

ORDERED that the assessment entered by the Comptroller against the Petitioners, as affirmed in the Comptroller's Notice of Final Determination dated October 6, 2008, be and the same hereby is

AFFIRMED.

CERTIFIED TRUE COPY
TEST: John T. Hearn, Clerk

NOTICE: You have the right of appeal from the above Order to the Circuit Court of any County or Baltimore City, wherein the property or subject of the assessment may be situated. The Petition for Judicial Review MUST be filed in the proper Court within thirty (30) days from the date of the above Order of the Maryland Tax Court. Please refer to Rule 7-200 et seq. of the Maryland Rules of Court, which can be found in most public libraries.

CC: ROBERT A. SNYDER, JR., ESQ.
MATTHEW F. PENATER, ESQ.
BRIAN L. OLINER, ESQ.

APPENDIX F

Annotated Code of Maryland, Tax-General Article

§ 10-102. Imposition of tax – In general

Except as provided in § 10-104 of this subtitle, a tax is imposed on the Maryland taxable income of each individual and of each corporation.

§ 10-103. County Income Tax.

(a) *Required.* – Each county shall have a county income tax on the Maryland taxable income of:

(1) each resident, other than a fiduciary, who on the last day of the taxable year:

(i) is domiciled in the county; or

(ii) maintains a principal residence or a place of abode in the county;

(2) each personal representative of an estate if the decedent was domiciled in the county on the date of the decedent's death;

(3) each resident fiduciary of:

(i) a trust that is principally administered in the county; or

(ii) a trust that is otherwise principally connected to the county and is not principally administered in the State; and

(4) except as provided in § 10-806(c) of this title, a nonresident who derives income from salary, wages, or other compensation for personal services for employment in the county.

(b) *Limitation.* – Except for the county income tax, a county, municipal corporation, special taxing district, or other political subdivision may not impose a general local income, earnings, or payroll tax, a general occupational license tax, or a general license or permit tax based on income, earnings, or gross receipts.

§ 10-703. For Tax Paid by Resident to Another State.

(a) *In general.* – Except as provided in subsection (b) of this section, a resident may claim a credit only against the State income tax for a taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year.

(b) *Exceptions.* – A credit under subsection (a) of this section is not allowed to:

(1) a resident other than a fiduciary, if the laws of the other state allow the resident a credit for State income tax paid to this State;

(2) a resident fiduciary, if the fiduciary claims, and the other state allows, a credit for State income tax paid to this State;

(3) a resident for less than the full taxable year for tax on income that is paid to another state during residency in that state; or

(4) a nonresident.

(c) *Amount of credit for resident.* – (1) Except as provided in paragraph (2) of this subsection, the credit allowed a resident under subsection (a) of this section is the lesser of:

(i) the amount of allowable tax on income that the resident paid to another state; or

(ii) an amount that does not reduce the State income tax to an amount less than would be payable if the income subjected to tax in the other state were disregarded.

(2) If the credit allowed a resident under subsection (a) of this section is based on tax that an S corporation pays to another state, the credit allowable to a shareholder:

(i) may not exceed that shareholder's pro rata share of the tax; and

(ii) will be allowed for another state's income taxes or taxes based on income.

OPPOSITION BRIEF

No. 13-485

IN THE
Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Petition for a Writ of Certiorari to the Maryland Court of Appeals

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Maryland Court of Appeals correctly held that although Maryland is permitted by the Due Process Clause to tax all of its residents' income wherever earned, the dormant Commerce Clause separately prohibits Maryland from double-taxing interstate commerce and imposing discriminatory burdens on interstate commerce through its tax code.

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IN THE

Supreme Court of the United States

No. 13-485

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Petition for a Writ of Certiorari to the Maryland Court of Appeals

BRIEF IN OPPOSITION

INTRODUCTION

For decades, this Court has understood the Constitution to impose two distinct restrictions on the states' power to tax: The Due Process Clause prohibits states from taxing value having no connection to the state, while the dormant Commerce Clause prohibits states from imposing duplicative or discriminatory taxes on interstate commerce. The former restriction protects individual taxpayers from state overreach; the latter protects the interstate market itself from undue burdens and economic Balkanization. Thus, a tax can be fair as to individual taxpayers, but unfair to interstate commerce.

This case was litigated in the Maryland Court of Appeals based on these settled principles. Indeed, Petitioner the Maryland State Comptroller of the

Currency (Comptroller) told the court below that all taxes, even state income taxes, must comply with the dormant Commerce Clause. And he expressly represented to the Court of Appeals in his merits brief that "when a citizen has to pay multiple taxes on the same income at the same level because the income was earned in a state in which he was not a resident," that "*is not * * * permitted.*" Pet'r Md. COA Opening Br. 10-11 (emphasis added). Only now, after the Court of Appeals held that Maryland's unique state income tax discriminates against interstate commerce, does the Comptroller deploy a truly novel theory: that states may burden interstate commerce all they wish, so long as they do so through a tax on their own citizens.

Reasons to deny the Comptroller's petition abound. For starters, the argument the Comptroller presses in this Court was not presented below until the reconsideration stage, *after* Maryland's high court issued its opinion. That court accordingly never considered on the merits the Comptroller's bold claim that a state's income tax on its own citizens is categorically immune from dormant Commerce Clause scrutiny. This Court should follow its customary practice and refuse to be the first tribunal to pass upon that untested argument.

Nor is there any conflict for this Court to resolve. The Comptroller compares apples and oranges when he insists that the decision below is at odds with this Court's holdings that a state may tax all its residents' income. The cases he points to—every single one—decided a distinct question: whether the *Due Process Clause* imposes any limit on the extent to which a state may tax its own residents. None of those cases addressed the question the Court of

Appeals resolved: whether the *dormant Commerce Clause* imposes independent limitations on the states' taxing authority. The court below understood that distinction. It held that Maryland's state income tax complies with the Due Process Clause but that it separately runs afoul of the dormant Commerce Clause and its concern for preserving a robust market for national trade.

There is also no conflict between the decision below and the state high court authority the Comptroller string-cites without any meaningful analysis. In most of the cited cases, there would not have been impermissible double taxation on this case's facts. And in the remaining cases, the state courts addressed issues far different from those confronted by the Court of Appeals.

Finally, the Comptroller's claim that the decision below will harm Maryland financially and cast doubt on similar taxing schemes "across the nation," Pet. 16, is misplaced. Maryland has tools available to lessen the burden of the decision below, and few jurisdictions have tax codes similar to the one the Court of Appeals found constitutionally infirm. To the extent the holding below may—or may not—influence future litigation, this Court would benefit from further deliberation by the lower courts and the joining of issues that comes only with the development of a true conflict.

The petition should be denied.

COUNTERSTATEMENT

A. Constitutional Limitations On State Taxation.

1. The Constitution places two primary limitations on states' power to tax. First, the Due Process Clause of the Fourteenth Amendment requires "some

definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax," *Miller Brothers Co.* v. *Maryland*, 347 U.S. 340, 344-345 (1954), and that the "income attributed to the State for tax purposes * * * be rationally related to the 'values connected with the taxing State,' " *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 273 (1978) (citation omitted). Applying these principles, this Court has held that a state may tax all of its residents' income wherever earned, and may tax nonresidents' income to the extent the income was earned within the jurisdiction, without running afoul of the Due Process Clause. *See Oklahoma Tax Comm'n* v. *Chickasaw Nation*, 515 U.S. 450, 463 & n.11 (1995).

Second, the dormant Commerce Clause separately "forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation." *MeadWestvaco Corp. ex rel. Mead Corp.* v. *Illinois Dep't of Revenue*, 553 U.S. 16, 24 (2008). Therefore, "[i]n order to prevent multiple taxation of interstate commerce, this Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 446-447 (1979). States typically avoid this constitutionally prohibited double taxation of interstate commerce by either apportioning a taxpayer's income among the jurisdictions in which it was earned or by allowing the taxpayer a credit for taxes paid to other states. *See* W. Hellerstein, *State Taxation* ¶ 8.02 (3d ed. 2013) (*State Taxation*).

2. Although the Due Process Clause and dormant Commerce Clause's restrictions are sometimes "closely related," *Nat'l Bellas Hess, Inc.* v. *Dep't of Revenue*, 386 U.S. 753, 756 (1967), they "pose distinct limits on the taxing powers of the States," *Quill Corp.* v. *North Dakota*, 504 U.S. 298, 305 (1992). That is because the clauses "reflect different constitutional concerns." *Id.* Whereas the Due Process Clause "ask[s] whether an individual's connections with a State are substantial enough to legitimate the State's power over him," the dormant Commerce Clause is "informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." *Id.* at 312. In other words, the dormant Commerce Clause does not protect individual taxpayers as such, but "secur[es] a national 'area of free trade among the several States' " by prohibiting discriminatory state taxation. *Associated Indus. of Mo.* v. *Lohman*, 511 U.S. 641, 650 (1994) (citation omitted).

The upshot of the two clauses' distinct prohibitions and concerns is that "[a] tax may be consistent with due process and yet unduly burden interstate commerce." *Quill Corp.*, 504 U.S. at 313 n.7. The two inquiries are "analytically distinct." *Id.* at 305.

B. Maryland's Partial-Credit Scheme.

1. Maryland imposes an individual state income tax made up of two parts: a "State tax" and a "county tax." Pet. App. 4a. So in 2006, for instance, residents of Howard County paid a total Maryland state income tax rate of 7.95 percent—a "State" rate of 4.75 percent, Md. Code Ann., Tax-Gen § 10-105(a)(4)(v) (2006), and a "county" rate of 3.2 percent, *id.* § 10-103. Despite the nomenclature the

state legislature chose, both portions of the tax are state-imposed, and it is settled law in Maryland that the so-called "county" tax is in fact a state tax. *Frey* v. *Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011).

Although both portions of Maryland's state income tax are imposed on a taxpayer's entire taxable income—regardless of where it is earned—a taxpayer may claim a credit for taxes paid to other states only against the State portion of the tax. Pet. App. 7a. The Maryland legislature set up this system quite intentionally; it "amended the income tax statutes to prohibit specifically the application of the out-of-state tax credit to county income tax." *Frey*, 29 A.3d at 492. And its choice means double taxation for residents who make money in other states.

An example illustrates the problem. Imagine that a Maryland small businessman earns $200,000 in income, half from work done in Maryland and half from work done in Virginia. And suppose Maryland's state and county income tax rates are 5 percent and 3 percent respectively (for a total of 8 percent) and Virginia's income tax rate is 8 percent. Maryland will tax him on his full $200,000 income at 8 percent, for a tax bill of $16,000. Virginia will tax him on the $100,000 he earned there at 8 percent, for a tax bill of $8,000 more. But Maryland—unlike other states—will not give him a credit for that $8,000 tax payment to Virginia. It will give him a credit for only $5,000, leaving him with $3,000 in double taxation. As the Court of Appeals explained, "a taxpayer with income sourced in more than one state will consistently owe more in combined state income taxes than a taxpayer with the same income sourced in just" Maryland. Pet. App. 22a.

2. Respondents Brian and Karen Wynne, longtime Maryland residents, are a married couple with five children. Pet. App. 9a. During the 2006 tax year at issue in this case, Brian Wynne owned a 2.4% stake in and was the President of Maxim Health Care Services, Inc., a national health-care services company. Pet. App. 9a, 26a-27a.

Maxim is an "S Corporation." Pet. App. 9a. S corporations are pass-through entities akin to partnerships, in that they "elect to pass corporate income, losses, deductions and credit through to their shareholders for federal tax purposes." Internal Revenue Serv., *S Corporations*.[1] The S corporation's shareholders, in turn, "report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income rates." *Id.* That means when an S corporation earns income in multiple states, the income is attributed to its owners, who then must then pay any income tax due. Pet. App. 8a-9a. And like federal law, Maryland attributes an S corporation's income to its shareholders for income-tax purposes. Pet. App. 8a.

3. In 2006, the Wynnes earned $2,667,133 in taxable income, much of it from Brian Wynne's stake in Maxim. Pet. App. 56a. Because 39 of the states in which Maxim operates have a personal income tax, the Wynnes paid $84,550 in taxes to other states. *Id.* And yet Maryland law did not allow the Wynnes to take a credit for all those tax payments. Instead, by denying a credit against the county portion of the state income tax, Maryland taxed the Wynnes a second time on the same income.

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[1] *Available at* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/S-Corporations.

Critically, if Maxim had earned its income exclusively in Maryland, the Wynnes would not have been double taxed. *See* Pet. App. 22a. The Maryland tax code thus penalized the Wynnes—and, indirectly, Maxim—for making money across state lines. *Id.*

C. The Decisions Below.

1. In the Maryland Tax Court, the Wynnes challenged the constitutionality of the state's partial-credit scheme. Pet. App. 10a. They argued that the partial-credit scheme violates this Court's *Complete Auto* test, which measures whether a state tax comports with the dormant Commerce Clause. *See Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 (1977). The Tax Court rejected their arguments in a short oral opinion. Pet. App. 135a-136a.

The Wynnes then sought judicial review in the Howard County Circuit Court, which reversed in a comprehensive written opinion. Pet. App. 53a-126a. The court held that by allowing state residents with out-of-state income only a partial credit against their state income taxes, Maryland authorizes "double taxation" and "substantially burdens its residents conducting business in interstate commerce, as compared to those conducting purely intrastate commerce." Pet. App. 54a. The court accordingly held that Maryland's tax scheme "violates the 'dormant' Commerce Clause of the U.S. Constitution." Pet. App. 126a.

2. The Comptroller appealed, and the Maryland Court of Appeals accepted review before briefing in the intermediate appellate court. Pet. App. 11a.

In the Court of Appeals, the Comptroller conceded that the dormant Commerce Clause forbids double taxation of interstate commerce. Pet'r Md. COA

Opening Br. 10-11. He argued, however, that Maryland's partial-credit scheme did not run afoul of this prohibition because it did not implicate interstate commerce. *Id.* at 9-20. The Comptroller also argued that Maryland's partial-credit approach satisfied the *Complete Auto* test. *Id.* at 21-26.

The Court of Appeals disagreed across the board. The court first held, correctly, that Maryland had the raw power to tax all of the Wynnes' income under the Due Process Clause. Pet. App. 12a. But, taking as a given the Comptroller's concession that the dormant Commerce Clause requires states to avoid double taxation of interstate income, Pet. App. 33 n.26, 51a-52a, the court held that Maryland's partial-credit system implicated interstate commerce because the double-taxation it caused "may affect the interstate market for capital and business investment" by "creat[ing] a disincentive for the taxpayer * * * to conduct income-generating activities in other states with income taxes." Pet. App. 16a-17a.

The Court of Appeals then analyzed Maryland's partial-credit scheme under each step of the *Complete Auto* test and found it was neither fairly apportioned nor neutral towards interstate commerce. Pet. App. 17a-32a. The Court of Appeals therefore concluded that the "the application—or lack thereof—of the credit to the county income tax" violated the dormant Commerce Clause. Pet. App. 34a.

3. The Comptroller moved for reconsideration and for a stay pending a petition for certiorari. Pet. App. 51a. And in his reconsideration motion, the Comptroller reversed course on practically every point of consequence. He admitted that Maryland's partial-credit scheme results in double taxation. Pet'r Md. COA Reconsideration Mot. 2. He also admitted that

this double taxation "make[s] it more difficult to conduct a business that crosses state lines." *Id.* at 3. But he nonetheless asserted—for the first time—that the dormant Commerce Clause does not constrain Maryland's power to double-tax its own residents' interstate income. *Id.* at 2, 5.

The Court of Appeals denied reconsideration. Pet. App. 50a-52a. But it agreed to stay its judgment pending this Court's disposition of the Comptroller's certiorari petition. *Id.*[2]

REASONS FOR DENYING THE WRIT

I. THE COMPTROLLER'S ARGUMENTS WERE NOT PRESSED OR PASSED UPON BELOW.

In this Court, the Comptroller presses the novel argument that a state's income tax on its own residents is categorically immune from dormant Commerce Clause scrutiny. Pet. 9-12. But the Comptroller did not make that argument below until the reconsideration stage, and expressly conceded the opposite in his merits brief. Because this Court does not " 'ordinarily consider' " arguments " 'neither raised before nor considered by' " the court below, *Pennsylvania Dep't of Corrs.* v. *Yeskey*, 524 U.S. 206, 212-213 (1998) (citation omitted), the petition should be denied.

1. It is axiomatic that this Court is "a court of review, not of first view." *Cutter* v. *Wilkinson*, 544 U.S. 709, 719 n.7 (2005). Thus an issue "not raised

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[2] On reconsideration, the Court of Appeals clarified that its decision requires only that Maryland remedy the double-taxation imposed by its partial-credit scheme, leaving the Comptroller to choose among credits, apportionment, or some other method. Pet. App. 51a-52a. The Comptroller's suggestion (Pet. i) that the decision below requires "a credit for taxes paid on income earned in other states" is simply not true.

[in the lower court] is not properly before" this Court. *Delta Airlines, Inc.* v. *August*, 450 U.S. 346, 362 (1981); *see also United States* v. *Ortiz*, 422 U.S. 891, 898 (1975) (declining to consider an issue "which was raised for the first time in the petition for certiorari"). The reason for the rule is straightforward: This Court prefers to have "the benefit of thorough lower court opinions to guide [its] analysis of the merits." *Zivotofsky ex rel. Zivotofsky* v. *Clinton*, 132 S. Ct. 1421, 1430 (2012); *see also Wellons* v. *Hall*, 558 U.S. 220, 225-226 (2010) (per curiam).

Here, the Comptroller did not present the argument he now presses—that States have constitutional carte blanche to double-tax their citizens—to the Maryland Court of Appeals when that court was adjudicating the merits. Quite the contrary: The Comptroller told the Court of Appeals in his merits brief that "when a citizen has to pay multiple taxes on the same income at the same level because the income was earned in a state in which he was not a resident," that "*is not* * * * *permitted*." Pet'r Md. COA Opening Br. 10-11 (emphasis added). The Comptroller instead contested whether Maryland's tax scheme even implicated interstate commerce and, if it did, whether the scheme satisfied this Court's commerce-clause test from *Complete Auto*. *Id.* at 9-26.

Having lost those arguments below, the Comptroller now seeks to change horses. But this Court ordinarily does not permit "a petitioner to assert new substantive arguments attacking * * * the judgment when those arguments were not pressed in the court whose opinion [this Court is] reviewing." *United States* v. *United Foods, Inc.*, 533 U.S. 405, 417

(2001). It should not allow the Comptroller to do so here.

2. The Comptroller may argue that the Court of Appeals nonetheless "passed upon" the question he now advances because the court necessarily concluded that the Commerce Clause did apply. *See United States* v. *Williams*, 504 U.S. 36, 41 (1992). But this Court has held that where a lower court applies a legal principle and there was "never 'any real contest' upon the point" between the parties, the larger principle has not been passed upon for purposes of this Court's review. *Illinois* v. *Gates*, 462 U.S. 213, 222-223 (1983) (citation omitted). So, for instance, where a state court applied the exclusionary rule in a criminal case and the parties never questioned its applicability, this Court would not entertain a challenge to the exclusionary rule's scope in the first instance. *Id.*

That is the case here. The Court of Appeals relied on the Comptroller's concession regarding the dormant Commerce Clause, taking it as a given that the dormant Commerce Clause prohibits double taxation. *See* Pet. App. 33 n.26. The issue was therefore not passed upon for purposes of this Court's review.

Nor did the Maryland Court of Appeals "pass upon" the Comptroller's late-breaking argument when it denied his motion for reconsideration. Reconsideration in Maryland is discretionary, *see Wilson-X* v. *Dep't of Human Resources*, 944 A.2d 509, 514 (Md. 2008), and denial of discretionary review is not a decision on the merits, *see Rypma* v. *Stehr*, 511 A.2d 527, 529 n.1 (Md. Ct. Spec. App. 1986). The Maryland Court of Appeals has therefore never passed upon the merits of the question the Comptroller now

presents. This Court should deny the petition for that reason alone.

II. THE DECISION BELOW ACCORDS WITH THIS COURT'S DUE PROCESS AND DORMANT COMMERCE CLAUSE CASES.

The Comptroller argues that the Court of Appeals' decision is contrary to this Court's cases holding that "a State may tax all of the income of its resident taxpayers, wherever earned." Pet. 9. But the Comptroller's so-called conflict is no conflict at all. That is because every decision cited by the Comptroller evaluated the scope of a state's taxing power under the Due Process Clause. The question posed by this case—and answered by the Court of Appeals—is whether Maryland's tax scheme violates the Commerce Clause's separate constitutional mandate. Because the Comptroller can point to no conflict on that question, further review is unwarranted.

1. The linchpin of the Comptroller's petition is this Court's supposed holding that the states may "tax *all* of the income of its resident taxpayers, wherever earned." Pet. 9. But the Comptroller stops reading his cited cases too soon. What they actually hold is that *as a matter of the Due Process Clause*, a state may tax all of the income of its resident taxpayers, wherever earned. In each case, the Court's holding referred to the scope of the Due Process Clause, not the dormant Commerce Clause's distinct limitations.

In *People ex rel. Cohn* v. *Graves*, 300 U.S. 308, 313 (1937), for instance, this Court held that "[a] state may tax its residents upon net income from a business whose physical assets [are] located wholly without the state." But the Court explicitly "limit[ed

its] review to the question considered and decided by the state court, whether there is anything in the Fourteenth Amendment which precludes the State of New York from taxing the income merely because it is derived from sources" outside of New York. *Id.* In *Lawrence* v. *Tax Commission of Mississippi*, 286 U.S. 276, 281 (1932), this Court held that a state may impose an income tax "on its own citizens with reference to the receipt and enjoyment of income derived from the conduct of the business, regardless of the place where it is carried on." But what the Comptroller fails to mention is that the taxing statute "was challenged on the ground that in so far as it imposes a tax on income derived wholly from activities outside the state, it deprived [the challenger] of property without due process of law." *Id.* at 279. And in *Guaranty Trust Co. of New York* v. *Virginia*, 305 U.S. 19, 22-23 (1938), although the Court held that "[t]he mere fact that another state lawfully taxed the funds from which the payments were made did not necessarily destroy [the state's] right to tax something done within its borders," the petitioner's challenge was only that "both the Equal Protection and Due Process clauses forbid the challenged exactment."

The list goes on. In each case, the party challenging the tax brought claims grounded in the Fourteenth Amendment, not the dormant Commerce Clause.[3] Even in *Chickasaw Nation*, which the

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[3] *State Tax Comm'n of Utah* v. *Aldrich*, 316 U.S. 174, 174 (1942) ("sole question" presented was whether the state "is precluded by the Fourteenth Amendment from imposing a tax."); *Curry* v. *McCanless*, 307 U.S. 357, 372 (1939) (finding "nothing in the history of the Fourteenth Amendment" that prohibited challenged tax); *Maguire* v. *Tefry*, 253 U.S. 12, 15 (1920) (the

Comptroller apparently views as his best authority (Pet. 9-11), the dormant Commerce Clause was not at play. This Court went out of its way to emphasize that the Indian Tribe's challenge to Oklahoma's tax there was a "narrow one" because the Tribe did not "complain that Oklahoma fails to award a credit against state taxes for taxes paid to the Tribe." 515 U.S. at 464 n.13. In other words, there was no claim of double taxation—and thus no dormant Commerce Clause issue—present in that case. *Id.*

The Comptroller insists the opposite, citing a footnote in *Chickasaw* that allegedly held that credits for income taxes paid to other sovereigns " 'is an independent policy decision' " and not constitutionally required. Pet. 11 (citing 515 U.S. at 463 n.12). But the footnote the Comptroller splices together snippets from says no such thing. What it says is that " '[i]f foreign income of a domiciliary taxpayer is *exempted*, this is an independent policy decision, and not one compelled by jurisdictional considerations.' " *Chickasaw Nation*, 515 U.S. at 463 n.12 (emphasis added; citation omitted). The footnote thus refers to a state's policy discretion to forgo some of its Due Process Clause authority to tax all of a resident's income, *not* the dormant Commerce Clause's demand that states avoid double taxation through credits or some other mechanism.

Perhaps realizing the limitations of what his cases say, the Comptroller appeals to what they *don't* say.

"contention" at issue was "that the imposition of the tax was a denial of due process of law within the protection of the Fourteenth Amendment"); *Shaffer* v. *Carter*, 252 U.S. 37, 58 (1920) (concluding that "nothing * * * in the Fourteenth Amendment prevents the states from imposing double taxation * * * so long as the inequality is not based up on arbitrary distinctions").

He argues that Maryland must be permitted to double-tax as it pleases because his cited cases "did not so much as hint" that the dormant Commerce Clause limited the taxes at issue. Pet. 12. But the reason this Court did not mention the dormant Commerce Clause is because the petitioners did not argue that the taxes at issue violated the dormant Commerce Clause. This Court's silence is of no help to the Comptroller. *See Stone* v. *Powell*, 428 U.S. 465, 481 n.15 (1976) (rejecting argument that the Court's prior cases resolved an issue because "the issue * * * was not presented" in the prior cases and "only in the most exceptional cases will [this Court] consider issues not raised").

2. With the Comptroller's cases appropriately cabined to the Due Process Clause, there is no conflict between them and the decision below. The Wynnes conceded—and the Court of Appeals held—that Maryland has the "authority to tax their income, wherever earned, under the Due Process Clause." Pet. App. 12a. The Court of Appeals' focus was exclusively on the dormant Commerce Clause and its independent restrictions on state taxation. *See id.* And the Comptroller does not even assert a conflict between the decision below and any of this Court's many dormant Commerce Clause cases striking down a state's taxes on its own citizens. *See, e.g.*, *Camps Newfound/Owatonna, Inc.* v. *Town of Harrison*, 520 U.S. 564 (1997) (striking down discriminatory tax imposed on in-state camp); *Fulton Corp.* v. *Faulkner*, 516 U.S. 325 (1996) (striking down discriminatory tax imposed on in-state securities holders).

Indeed, Professor Hellerstein—the leading authority on state and local taxation[4]—addressed the decision below in the most recent update to his *State Taxation* treatise and concluded that the Court of Appeals properly held that "a state taxing income on a residence basis must, as a matter of Commerce Clause doctrine, yield to a state that has the power to tax income on a source basis to avoid the risk of multiple taxation." *State Taxation* ¶ 20.10[2][b] n.783.10. There is not only no conflict between the Court of Appeals' decision and this Court's cases; the Court of Appeals' decision is correct. The petition should be denied.

III. THE COMPTROLLER'S ASSERTED SPLIT AMONG STATE HIGH COURTS IS ILLUSORY.

The Comptroller similarly misses the mark in arguing that the decision below conflicts with the decisions of multiple state courts of last resort. Pet. 13-14. Like the Comptroller's claims of conflict with this Court, his string-cite of state high court decisions conflates distinct doctrines and ignores key factual differences between those cases and this one. The split is illusory, and the petition should be denied.

1. Most of the Comptroller's cited cases are inapt because if the Wynnes resided in the states at issue,

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[4] Professor Hellerstein's treatise (and related law review articles) are cited in virtually every one of this Court's dormant Commerce Clause taxation cases. *See, e.g.*, *MeadWestvaco*, 553 U.S. at 25; *Am. Trucking Ass'ns, Inc.* v. *Schneiner*, 483 U.S. 266, 289 (1987); *Maryland* v. *Louisiana*, 451 U.S. 725, 758 n.28 (1981). His extensive work has led the Second Circuit to call him "[t]he leading commentator on the subject" of the constitutionality of state taxing schemes. *Barringer* v. *Griffes*, 1 F.3d 1331, 1336 (2d Cir. 1993).

the Wynnes could have credited their taxes paid to other states against their state income-tax bill. There would therefore be no double taxation and no dormant Commerce Clause violation.

Minnesota, for instance, grants resident taxpayers—regardless of whether they are domiciled in the state—a credit for taxes paid to other states. *See* Minn. Stat. § 290.06(22). Thus, in both cases the Comptroller cites (Pet. 13), the Minnesota Supreme Court emphasized that Minnesota's taxation of nondomiciliary residents' entire income did not offend the constitution because the Minnesota tax code "protect[s] residents from multiple taxation by allowing a credit for income taxes paid to the domicile jurisdiction to offset Minnesota income tax liability." *Stelnzer* v. *Comm'r of Revenue*, 621 N.W.2d 736, 740 n.1 (Minn. 2001); *see also Luther* v. *Comm'r of Revenue*, 588 N.W.2d 502, 510 (Minn. 1999) (explaining that "even if the risk of multiple taxation of individual taxpayers was a due process concern, no such taxation would result here because Minnesota provides a credit for income tax paid to a nondomiciliary resident's state of domicile").

Connecticut and New York, too, would provide a state income tax to the Wynnes in these circumstances. Their high courts have noted that although their respective states' tax codes do not allow a credit for taxes paid to other states on *intangible* income—such as dividends and interest—they *do* allow a credit on income derived from interstate businesses like the Wynnes' income from Maxim.

In Connecticut, " 'the credit against Connecticut income tax is allowed for income tax imposed by another jurisdiction upon * * * income from a business, trade or profession carried on in other jurisdic-

tion.' " *Chase Manhattan Bank* v. *Gavin*, 733 A.2d 782, 804 nn.26-27 (Conn. 1999) (quoting Conn. Agencies Regis. § 12-704(a)-4(3)). The same is true in New York. " '[T]he resident credit against ordinary tax is allowable for income tax imposed by another jurisdiction upon compensation for * * * income from a business, trade, or profession carried on in the other jurisdiction.' " *Tamagni* v. *Tax Appeals Tribunal*, 695 N.E.2d 1125, 1129 (N.Y. 1998) (quoting N.Y. Comp. Codes R. & Regs. Tit. 20, § 120.4(d)).

In both states, the credit for income derived from interstate activities "protects residents actually engaged in interstate commerce from double taxation by ensuring that they are taxed only once upon income derived from interstate activities." *See id.* But that is the very protection that Maryland's partial-credit scheme denies. Pet. App. 32a.

2. *Tamagni* is distinguishable for another reason as well. There, only intangible income was at issue. 695 N.E.2d at 1129. That is critical because under this Court's cases, intangible income has no situs; that is, the income is not considered to be from any particular geographic source. *See Aldrich*, 316 U.S. at 179-180. As a consequence, the *Tamagni* court concluded that the potential for multiple taxation of the taxpayer's intangible income did not implicate the dormant Commerce Clause. Because the income was not earned in a state other than New York, New York's denial of a credit was not a tax affecting interstate income. 695 N.E.2d at 1130.

This case is worlds apart. Under Maryland law, the Wynnes' pass-through income from Maxim is deemed earned in the states Maxim earned it. Pet. App. 8a. It therefore implicates the dormant Com-

merce Clause, and, as the Court of Appeals recognized (Pet. App. 16a n.15), *Tamagni* is inapplicable.

3. The Comptroller's remaining state high-court cases are similarly off-base. *Idaho Tax Commission* v. *Stang*, 25 P.3d 113, 116 (Idaho 2001), for instance, does not split with the decision below because the taxpayers' *only* dormant Commerce Clause argument was that Idaho lacked a sufficient nexus with their income. Here, by contrast, the Wynnes conceded that Maryland had the necessary connection to their Maxim income; they argued only that Maryland's income tax was discriminatory and not fairly apportioned. Pet. App. 17a-18a. The two cases do not address the same issues, and there therefore can be no conflict between them. *See MeadWestvaco*, 553 U.S. at 25 (noting the distinction under the dormant Commerce Clause between "whether the State may tax" and "what it may tax").

In *In re Barton-Dobenin*, 9 P.3d 9 (Kan. 2000), the Kansas Supreme Court denied a credit to resident taxpayers, but considered only the dormant *foreign* Commerce Clause—a clause about which the court confessed it had "very little guidance." *Id.* at 15. Moreover, the Kansas court based its holding on its view that the taxpayers there had not carried their evidentiary burden to prove that the Kansas tax "implicate[d] foreign commerce." *Id.* at 16. The Comptroller, however, does not contest the Court of Appeals' finding that Maryland's partial-credit scheme "may affect the market for capital and business investment." Pet. App. 16a-17a. And even if he did, this Court does not use its discretionary docket to second-guess fact-specific conclusions of that sort. *See* Sup. Ct. R. 10.

Finally, the Oregon Supreme Court in *Keller* v. *Department of Revenue*, 872 P.2d 414 (Or. 1994) denied taxpayers a credit against their Oregon income taxes on a tax paid to Washington state because it held that the Washington state tax was an excise—not income—tax. *Id.* at 415. Accordingly, there was no double-taxation of the taxpayers' non-Oregon income because the Washington state tax was not *on* the taxpayers' income. *Id.* at 415-416 (rejecting the taxpayers' dormant Commerce Clause arguments because "they proceed from the faulty premise that the Washington [excise] tax is an income tax"). But the taxes the Wynnes paid to other states are indisputably income taxes, Pet. App. 9a, and there is therefore no split between *Keller* and the decision below.

4. The Comptroller and his *amici* also argue that the decision below splits with various state intermediate appellate court decisions. Pet. 14 (citing *Zunamon* v. *Zehnder*, 719 N.E.2d 130 (Ill. App. Ct. 1999)); IMLA Br. 8 (citing *Christman* v. *Franchise Tax Board*, 134 Cal. Rptr. 725, 732 (Ct. App. 1976), and *Boone* v. *Chumley*, 372 S.W.3d 104 (Tenn. Ct. App. 2001)). This Court, however, reserves its review for splits among state courts of last resort, not lower state courts. *See* Sup. Ct. R. 10(b); *Huber* v. *New Jersey Dep't of Envtl. Prot.*, 131 S. Ct. 1308, 1308 (2011) (Alito, J., statement respecting denial of certiorari).

In any event, all three cases are distinguishable. The uncredited tax at issue in *Zunamon* was a "replacement" tax designed to equalize taxation between corporations that did not pay Illinois' personal property tax and individuals who did. 719 N.E.2d at 136. Such a tax might be deemed "compensatory"

and exempted from dormant Commerce Clause scrutiny. *See Oregon Waste Sys., Inc.* v. *Dep't of Envtl. Quality*, 511 U.S. 93, 102-103 (1994) (describing the compensatory-tax doctrine). But the Comptroller has not suggested Maryland's partial-credit scheme is a compensatory tax, Pet. App. 32a n.25, and therefore *Zunamon* does not conflict with the Court of Appeals' decision.

Christman and *Boone*, meanwhile, are inapt because they both involved taxation of dividends, not pass-through income. Indeed, the Comptroller's *amici* concede (IMLA Br. 8 n.4), that *Christman* treated the S-corporation distributions at issue as dividends, not pass-through income. 134 Cal. Rptr. at 732; *see also Valentino* v. *Franchise Tax Bd.*, 105 Cal. Rptr. 2d 304, 310 (Ct. App. 2001) (distinguishing *Christman* on this basis). In *Boone*, too, the Tennessee Court of Appeals emphasized that Tennessee's state income tax fell *only* on the portion of the S-corporation's distributions that were declared as dividends, *not* the full amount of income passed through to the taxpayers. 372 S.W.3d at 111-112. Those distinctions are crucial because—as we've explained—dividends are different for dormant Commerce Clause purposes. *Supra* 19-20. Further review is unwarranted.

IV. THIS COURT'S REVIEW IS UNNECESSARY AT THIS TIME.

The Comptroller's predictions of fiscal ruin for Maryland's counties and nationwide chaos in state and local taxation (Pet. 15-17) likewise do not support this Court's review. The actual impact of the decision below on Maryland's finances is uncertain and Maryland has tools available to mitigate any impact on its counties' coffers in the future. Moreo-

ver, contrary to the Comptroller's claims (Pet. 16), many jurisdictions *do* allow a credit for taxes paid to other states. And to the extent some jurisdictions have credit schemes similar to Maryland's, this Court should wait to see if a real split among the states develops.

1. The Comptroller's principal reason for claiming this case is one of national importance is that under the Court of Appeals' decision, Maryland will have to forgo $45 to $50 million per year in tax revenue and potentially refund up to $120 million in unlawfully levied taxes. Pet. 15. Of course, the magnitude of an unconstitutional tax is no basis to uphold it. *See C & A Carbone, Inc.* v. *Town of Clarkstown, N.Y.*, 511 U.S. 383, 393-394 (1994) ("[R]evenue generation is not a local interest that can justify discrimination against interstate commerce."). Regardless, Maryland's predictions of local fiscal hardship can be mitigated in the future and Maryland's obligation to pay refunds may not be as great as the Comptroller predicts.

As for future tax revenue, Maryland may always petition Congress to allow its discriminatory partial-credit system. *See Lewis* v. *BT Inv. Managers*, 447 U.S. 27, 44 (1980) (Congress may "confe[r] upon the States an ability to restrict the flow of interstate commerce that they would not otherwise enjoy"). And even without congressional action, Maryland can recoup the funds lost by the elimination of its partial-credit scheme by increasing sales or property taxes—which are not subject to credit or apportionment—or by raising all residents' county tax rates. *See* Pet. App. 33a n.26.

Such increases may prove locally unpopular. But that is the point of the dormant Commerce Clause:

Understanding it is more politically palatable to raise revenue by imposing higher taxes on interstate commerce, the Clause takes the choice from the states and places it with Congress, which legislates in the national interest. *See Carbone*, 511 U.S. at 393-394 (legitimate desire to fund local services does not justify imposition of discriminatory burdens on interstate commerce); *City of Philadelphia* v. *New Jersey*, 437 U.S. 617, 627 (1978) (a "presumably legitimate goal" may not "be achieved by the illegitimate means of isolating the State from the national economy"). That Maryland may have to make hard choices to replace the income lost from the Court of Appeals' elimination of its discriminatory taxing scheme is consistent with this Court's cases and does not support further review.

As for the Comptroller's fear that he will have to refund $120 million in illegally levied taxes (Pet. 15), it is premised on an untested hypothesis: that every person entitled to a refund will claim one.[5] In any event, the supposed burden of retroactive refunds is a result of Maryland's decision to allow its taxpayers to claim a refund for unlawfully collected taxes for up

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[5] The Comptroller's refund fears also assume that the Court of Appeals' decision will be retroactive. Although that is an accurate assumption, *see McKesson Corp.* v. *Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 22 (1990), the Comptroller neglects to mention that he has staked out the opposite position before the Maryland Court of Appeals. *See* Pet'r Md. COA Reconsideration Reply 12-13 (arguing that the Court of Appeals' decision should not be retroactive for taxpayers other than the Wynnes). Because the specter of refunds looms so large in the Comptroller's petition and the brief of his *amici*, this Court should wait to see whether the Maryland courts adopt the Comptroller's view on retroactivity before considering the otherwise idiosyncratic issue in this case.

to three years. *See* Md. Code Ann., Tax-Gen § 13-1104(c). Maryland was not required to provide such a generous refund window, *see McKesson Corp.*, 496 U.S. at 45, but having decided to allow it as a matter of policy, it can hardly support review by this Court. Moreover, Maryland may also have some additional tools to reduce the impact of any retroactive refunds on its counties, *see id.*, to the extent they are consistent with Maryland law. But Maryland's need to pay refunds to those it has unlawfully taxed does not make this straightforward case one of national importance.

2. Similarly, the Comptroller's fear (Pet. 16-17) that the decision below will imperil taxes levied by other jurisdictions is both premature and unfounded.

It is premature because the Maryland Court of Appeals' decision applies only in Maryland. For that reason, the Comptroller admits that the decision below will affect other states' taxes only if "[t]he premise embraced by the Court of Appeals" is "adopted by other courts." Pet. 16. Therefore, even assuming that the Comptroller is correct (Pet. 16-17) that the decision below renders "tax schemes in other jurisdictions around the nation * * * constitutionally suspect"—and he is not—this Court should permit the question presented to percolate before accepting it for review. *See* E. Gressman, *et al.*, *Supreme Court Practice* § 6.37(i)(1), p. 504 (9th ed. 2007) ("The more important an issue is, the more the Court would benefit by allowing the issue to percolate so it can avail itself of the wisdom of other courts before settling a momentous matter").

The Comptroller's fear is also unfounded because at the state level, "every state with a broad-based personal income tax provides a credit for taxes that

their residents pay to other states." *State Taxation* ¶ 20.10.[6] The Comptroller is thus left to fret about the possible consequences at the local level. Pet. 16.

But even those fears are overblown. Of the 4,943 local income taxes identified by the Comptroller's cited source, almost half—2,469—are in Pennsylvania. *See* J. Henchman & J. Sapia, *Tax Foundation Fiscal Fact No. 280*, at 1 (2011).[7] And Pennsylvania, contrary to the Comptroller and his *amici*'s claim, allows the "payment of any tax on income to any state other than Pennsylvania or to any political subdivision located outside [Pennsylvania] to * * * be credited to and allowed as a deduction from the liability of [the resident] for any other tax on [income] imposed by any *political subdivision* of" Pennsylvania. 53 Pa. Stat. Ann. § 6924.317 (emphasis added). The Philadelphia website quoted by the Comptroller's *amici* (IMLA Br. 17-18) refers to the denial of credits to *non-residents*, who do not need credits from Philadelphia to avoid double taxation because the city can tax non-residents only on in-

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[6] *Amici*'s citation (IMLA Br. 16, 18) to Wisconsin, North Carolina, and Massachusetts' credit rules are not to the contrary. It is irrelevant that Wisconsin and North Carolina do not allow credits for taxes paid to localities because the "county" portion of Maryland's state income tax is a state—not local—tax. Pet. App. 13a. Moreover, the gross receipt taxes Massachusetts declines to credit are not taxes on income. Mass. Dep't of Revenue, Directive 08-7: Gross Receipts-Based Taxes (Dec. 18, 2008), *available at* http://www.mass.gov/dor/businesses/help-and-resources/legal-library/directives/directives-by-decade/2000-2009-directives/directive-08-7-gross-receipts-based-taxes-.html. Thus, as with *Keller*, disallowing a credit does not result in Massachusetts double-taxing income. *Supra* 21.

[7] *Available at* http://taxfoundation.org/sites/taxfoundation.org/files/docs/ff280.pdf.

come earned within its borders. Phila. Income Tax Reg. § 207. Indiana's 91 county-level income taxes, meanwhile, allow residents to credit taxes paid to other counties, significantly reducing the threat of multiple taxation. *See* Ind. Code § 6-3.5-6-23(a).

To the extent there may be some local jurisdictions that have a partial-credit scheme like Maryland's, those states' high courts should be permitted to weigh in before this Court accepts review. In short, if the holding below is truly as novel as the Comptroller claims (Pet. 16), this Court should wait to see if it spreads before passing upon it.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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November 2013

REPLY BRIEF

No. 13-485

In The
Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,

Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals of Maryland

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

Few constitutional principles are more firmly established than the right of states "to tax all income of their residents, including income earned outside their borders." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 463 n.12 (1995); *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937); *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932). As this Court has repeatedly recognized, that broad authority is grounded in the special relationship between a sovereign and its residents. *See, e.g., Cohn*, 300 U.S. at 313. By virtue of that relationship, a state undertakes unique responsibilities for the care and protection of those who claim residency within its borders. In turn, those residents bear heightened obligations to provide support through payment of taxes. *See id.*

The decision below upends this fundamental understanding. Convinced that it had unearthed a new, overriding constitutional limitation on state taxing power, the Maryland Court of Appeals decided that this Court's repeated pronouncements affirming a state's authority to tax all its residents' income, wherever earned, do not tell the whole story. According to the Court of Appeals, this broad taxing authority is subject to a substantial caveat: a state may *not* tax all its residents' income if the income is earned and taxed in another state. To reach this unorthodox conclusion, the court brushed aside Maryland's inherent sovereign power to tax its residents and resorted to an inapt test for examining state taxing authority under the Commerce Clause.

This novel recasting of state sovereignty, with its oppressive effect on Maryland's treasury, warrants this Court's attention.

The Wynnes' brief in opposition does little to show otherwise. Apart from a flimsy forfeiture contention that is patently belied by the record, their arguments depend on the implausible notion that, for nearly a century, this Court, lower courts, and litigants have simply overlooked a supposed Commerce Clause restriction on states' power to tax their residents' income. This theory is defeated, however, by this Court's own decisions, which do not merely *state* the principles governing taxation of residents, but also *explain* the origins and rationale for a sovereign's broad taxing powers in a way that is flatly inconsistent with the existence of superseding limitations under the Commerce Clause. And the Wynnes' attempt to play down the severe impact of the decision below on Maryland's treasury—in particular, their suggestion that the State should just raise other taxes—merely underscores why states must have broad latitude to set their own tax policies, constrained only by the democratic process and genuine constitutional limits, not ones imagined by litigants seeking to evade their fiscal responsibilities as state residents.

The petition should be granted.

1. Seizing on one opaquely phrased sentence in the briefs below, the Wynnes claim that the Comptroller renounced the argument that Maryland may tax its residents' entire income, whether earned within the State or not.[1] The Court of Appeals perceived no such forfeiture. That court stated plainly that the Comptroller's argument was "based on a state's power to tax its own residents." Pet. App. 15. The court then rejected the argument that Maryland could tax all of the Wynnes' income based on their "status as Maryland residents" and declared that the Wynnes are "subject to the income tax because they are Maryland residents *and* because they have income derived from intrastate and interstate activities." *Id.* Building on that non sequitur, the court decided that Maryland's ability to tax its residents' income should be subject to extensive scrutiny (and, ultimately, curtailment) under the Commerce Clause. It is precisely that unprecedented—and quite mistaken—view of state sovereignty that the Comptroller challenges here.

The Court of Appeals' understanding of the Comptroller's argument was amply supported by the briefs below. His opening brief unequivocally stated that "Maryland, like all states, has the power to tax its residents on all of their income regardless of

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[1] As written, the sentence reads: "What is not necessarily constitutionally permitted is when a citizen has to pay multiple taxes on the same income at the same level because the income was earned in a state in which he was not a resident." C.A. Brief 10. The Wynnes twice alter the quote to omit the word "necessarily." Opposition 2, 11.

where that income is earned." C.A. Brief 9 (citing *Cohn*, 300 U.S. at 312-13); *see also id.* ("'[A] jurisdiction, such as [Maryland or Howard County], may tax *all* the income of its residents, even income earned outside the taxing jurisdiction.'" (quoting *Chickasaw Nation*, 515 U.S. at 462-63)). The brief stated that the Wynnes' income was taxed because "they were residents of Maryland during the taxable year" and because they "lived in Howard County." C.A. Brief 10. The Comptroller explained that the Wynnes' obligation to pay Maryland and Howard County income taxes is "based on their '[e]njoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws,' because these privileges and rights are 'inseparable from the responsibility for sharing the costs of government.'" *Id.* (quoting *Cohn*, 300 U.S. at 312-13). Finally, the Comptroller stated, "'[t]hese are rights and privileges which attach to domicile within the state,' and neither the privileges nor the income tax burden associated with those privileges are 'affected by the character or source from which the income is derived.'" C.A. Brief 10 (quoting *Cohn*, 300 U.S. at 313).

The Comptroller's reply brief placed similar emphasis on the breadth of the State's taxing power over its own residents. He reiterated that the State had "exercise[d] its taxing authority over *all* of the Wynnes' income due to their status as residents of the State." C.A. Brief 9. And, while observing that Maryland had provided substantial credits for taxes the Wynnes paid to other states, he insisted that the State was "under no constitutional obligation to do

so." *Id.* at 11-12. The brief also cited decisions from other states rejecting attempts by resident taxpayers to avoid their home states' taxes by invoking the Commerce Clause, *see id.* 4-9, several of which were distinguished (incorrectly) by the Court of Appeals, Pet. App. 15-16 n.15. Not surprisingly, therefore, even the Wynnes' counsel seemed well aware that the Comptroller was claiming a residency-based right to tax all the Wynnes' income. At oral argument, their counsel summed up the Comptroller's position by saying that, if his view of the State's constitutional authority "were true, . . . then states could always simply say, well, by virtue of your residency, we're going to tax you on everything and refuse to give credits." Transcript 26:05-13.

The Wynnes' claim of forfeiture is thus an empty one. The merits of the decision below are properly before the Court, and the Court should address them.

2. This Court has repeatedly said that a State may "tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Chickasaw Nation*, 515 U.S. at 462-63; *see* Petition 9 (citing cases). If this principle is correct, then the decision below is not. Its core holding is that the Commerce Clause *prohibits* a state from taxing all the income of its residents if that income is taxed by another state. In the Comptroller's view, that holding is wholly unfounded. But, at the very least, this Court, not the Maryland Court of Appeals, should have the final word about whether this Court has misapprehended the extent of state taxing powers for nearly 100 years.

The Wynnes argue that the Maryland court was free to disregard this Court's pertinent precedents because the protesting taxpayers in those cases did not call attention to the Commerce Clause and this Court saw no need to address it. That reticence offers little support for either the lower court's analysis or the Wynnes' insistence that further review is unwarranted. The Commerce Clause has been part of the Constitution since the founding of the Republic, and it is telling that, in all that time, no Justice of this Court has even intimated that the Commerce Clause diminishes a state's power to tax its residents' income. It seems highly improbable that this Court would have recently described the sovereign power to tax a resident's entire income as "a well-established principle of interstate and international taxation," *Chickasaw Nation*, 515 U.S. at 462, if the Court harbored any suspicion that this "well-established principle" was contrary to the dictates of a hardly-obscure provision like the Commerce Clause.[2]

Even more significant, this Court has not just said that states may tax all their residents' income, it has

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[2] The Court in *Chickasaw Nation* further characterized a sovereign's choice not to tax all of its residents' income as "an independent policy decision and not one compelled by jurisdictional considerations." 515 U.S. at 463 n.12. The Wynnes try to confine this observation to decisions that "exempt" income from tax, rather than decisions that grant credits for taxes paid elsewhere, but that wishful reading is foreclosed by the Court's own reference to "credit[s]" as an example. *See id.*

explained why that is so. A state's special power to tax its residents' income "is founded upon the protection afforded to the recipient of the income by the state," *Lawrence*, 286 U.S. at 281, which bears a special responsibility for the care and protection of its own citizens. Correspondingly, "[e]njoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government. . . . These are rights and privileges which attach to domicil within the state." *Id.*; *see Cohn*, 300 U.S. at 313. A state's power to tax its residents is thus part of a reciprocal bargain: the state extends unique privileges to its residents, and those residents accept an enhanced responsibility for supporting their home state.

The Wynnes ignore completely the special privileges enjoyed by state residents. But Maryland not only provides the basic governmental structure that protects its residents, it offers those residents significant benefits that are unavailable to non-residents. To take just a few examples, only Maryland residents are entitled to preferential admissions and reduced tuition at State universities, *see Frankel v. Board of Regents*, 361 Md. 298, 302-03 (2000); Univ. Sys. of Md. Policy III-4.0, are eligible for a broad array of public-assistance programs, *see, e.g.*, Code Md. Regs. 07.03.07.03(A)(1), 07.03.17.08(A)(2), 07.03.21.03(A)(1), and may obtain subsidized medical care under the State's expanded Medicaid program, *see* Code Md. Regs. 10.09.24.05-3(A). Conversely, Maryland residents have no right

to demand such benefits from other states, even if they pay income taxes there.

The Wynnes insist that the Constitution shelters them from "double taxation." Again, however, their theory runs headlong into contrary authority. This Court has frequently recognized that multiple states may tax the same income, so long as each state has a legitimate, freestanding basis for doing so. *See, e.g., State Tax Comm'n v. Aldrich*, 316 U.S. 174, 178 (1942) ("[I]ncome [from intangibles] may be taxed both by the state where it is earned and the state of the recipient's domicile."); *Curry v. McCanless*, 307 U.S. 357, 367-68 (1939); *Guaranty Trust Co. v. Virginia*, 305 U.S. 19, 23 (1938). That is the situation here: Maryland has the right to tax the Wynnes' entire income—wherever earned—because they are Maryland residents; another state may tax this income only insofar as it is earned within that state's borders. In light of these independent grounds for taxation, neither state is required to yield to the other in assessing taxes for the support of its government.

Unlike the Maryland Court of Appeals, other state courts have acknowledged a state's right to tax all the income of its residents and have rejected limitations assertedly imposed by the Commerce Clause. For example, in *Keller v. Department of Revenue*, the Oregon Supreme Court held that Oregon residents did not have an absolute right to credit out-of-state taxes against their Oregon income

tax, stating that it "[did] not read *Complete Auto Transit, Inc.* [a Commerce Clause case[3]] to alter the rule that Oregon is entitled to tax the income of its residents." 872 P.2d 414, 416 (Ore. 1994) (citing *Lawrence*, 286 U.S. at 276). Likewise, in discussing "[t]he inapplicability of dormant Commerce Clause analysis to State resident income taxation," the New York Court of Appeals specifically noted that "[t]he Supreme Court has long held that multiple taxation of State residents is not forbidden." *Tamagni v. Tax Appeals Tribunal*, 695 N.E.2d 1125, 1134 (N.Y. 1998) (citing *Aldrich*, 316 U.S. at 174; *Cohn*, 300 U.S. at 313; and *Fidelity & Columbia Trust Co. v. Louisville*, 245 U.S. 54 (1917)). Rebuffing the same "nobody ever thought of the Commerce Clause" argument that the Wynnes make here, the New York court stated pointedly: "While this line of cases involved due process challenges, the very fact that the dormant Commerce Clause was never mentioned as a limitation on State power to tax resident income suggests that there is no such limitation." 695 N.E.2d at 1134.[4]

Given these decisions, it is striking that the Wynnes cannot cite a single decision of this Court relying on the Commerce Clause to invalidate state income taxes based on residency; indeed, they are unable to cite such a case from any court other than

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[3] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

[4] The Comptroller agrees with the New York court that, if a Commerce Clause analysis applies, it does not bar full taxation of a resident's income. *See Tamagni*, 695 N.E.2d at 1133-34.

the one below. That is hardly surprising, because taxes on individual income rarely, if ever, implicate what this Court has described as the driving concern of the Commerce Clause: "economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Department of Revenue v. Davis*, 553 U.S. 328, 337-38 (2008).[5] Even the Wynnes' favored tax treatise can say only that the question presented in this petition is "a complicated question for which the courts have yet to provide a definitive answer." W. Hellerstein, *State Taxation* ¶ 20.10[2][b] (3d ed. 2013). It is simply insupportable therefore, for the Wynnes to proclaim that the court below decided this case by applying "settled principles." Opposition 1.

This petition presents a straightforward question: does a state have the sovereign power to tax all the income of its residents, even if part of that income is earned in, and taxed by, other states? Taking their lead from repeated decisions of this Court, the highest courts of Oregon and New York, as well as courts in other states, *see* Petition 13-14, would say yes; the Maryland Court of Appeals, standing alone, has declared that the answer is no. This Court should grant review to settle this critical question of state taxing power.

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[5] By comparison, the two Commerce Clause cases the Wynnes point to as supporting the decision below, Opposition 16, both involve preferential tax treatment for businesses based on their in-state activities. *See Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564 (1997); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996).

3. The Wynnes do not seriously dispute that, if allowed to stand, the decision below will have a substantial impact on Maryland tax revenues. Although the exact amounts are not known, the State estimates that the decision will cost the State approximately $50 million each year in future tax revenues, plus as much as $120 million in possible refunds. While it is obviously true that "the magnitude of an unconstitutional tax is no basis to uphold it," Opposition 23, the magnitude of a tax *is* a reason for this Court to review a decision holding the tax unconstitutional, especially when that decision overturns decades of common understanding.

The Wynnes' primary solution to the shortfall calls for the State to "increas[e] sales or property taxes" or to "[r]aise all residents' county tax rates." Opposition 23. Although the Wynnes frankly acknowledge that their proposed tax increases "may prove locally unpopular," they insist that "the point of the dormant Commerce Clause" is to counteract the fact that "it is more politically palatable to raise revenue by imposing higher taxes on interstate commerce." Opposition 23-24. But that supposed purpose has little to do with taxes based on residency. If, by denying full credits, Maryland is imposing "higher taxes," it is imposing them on Maryland residents—that is, voters—hardly an illustration of the "politically palatable" strategy the Wynnes condemn. *See McCulloch v. Maryland*, 4 U.S. (Wheat.) 316, 428 (1819) ("In imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation."). Precisely because residents

are "able to complain about and change [a challenged] tax through [their state's] political process," this Court has emphasized that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989).

Finally, the decision below has potential repercussions beyond Maryland. While most states provide full credits for income taxes paid to other states, many local jurisdictions do not. *See* IMLA Amicus Brief 16-18. The Wynnes do not deny that their wide-ranging Commerce Clause theory would invalidate those tax codes; instead, they argue only that code variations might shelter some jurisdictions from its full effect. Opposition 26-27. That is cold comfort. As long as the decision below remains in place, any jurisdiction taxing its residents' entire income will face needless uncertainty about the viability of its tax system and its potential exposure to onerous refund claims.

The Wynnes have offered no good reason to deny review. The new doctrine announced by the Maryland Court of Appeals dramatically departs from the foundational principle that states may tax all their residents' income. There is no justification for this counter-historical rule, and the decision mandating it is both important and gravely wrong. This Court should grant review to correct it.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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AMICUS CURIAE BRIEF

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In the Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
PETITIONER

v.

BRIAN WYNNE, ET UX.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF MARYLAND

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

The State of Maryland funds county-level services in part through taxes on the income of each county's residents. The question presented is as follows:

Whether the Commerce Clause entitles Maryland residents to reduce or eliminate their residential county income-tax obligation based on their payment of income taxes to other States in which they do not reside.

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In the Supreme Court of the United States

No. 13-485

COMPTROLLER OF THE TREASURY OF MARYLAND, PETITIONER

v.

BRIAN WYNNE, ET UX.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF MARYLAND

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the order of the Court inviting the Solicitor General to express the views of the United States. In the view of the United States, the petition for a writ of certiorari should be granted.

STATEMENT

1. The State of Maryland funds its operations in part through taxes on the income of its residents. Pet. App. 4-5. Each resident is subject to a general state income tax at a rate specified by the legislature. Md. Code Ann. Tax-Gen. §§ 10-102, 10-105(a) (LexisNexis 2010) (Md. Tax Code). Each resident is also subject to a county income tax at a rate not to exceed 3.2%, to be specified by the county in which he is domiciled or has a principal place of residence on the last day of the taxable year. *Id.* §§ 10-103, 10-106. Both sets of taxes are collected by petitioner, Maryland's Comptroller of

the Treasury, who then distributes the proceeds of the county income tax to the appropriate county. Pet. App. 5.

If a Maryland resident earns income in another State, the income may also be subject to taxation in that State. In addition to imposing income (and other) taxes on its own residents, a State may tax the income that non-residents earn within its borders. See, *e.g.*, *Oklahoma Tax Comm'n* v. *Chickasaw Nation*, 515 U.S. 450, 463 n.11 (1995) (citing *Shaffer* v. *Carter*, 252 U.S. 37, 57 (1920)). Maryland applies its state income tax (along with a special nonresident tax in place of the county tax) to income earned in Maryland by non-residents. Md. Tax Code §§ 10-102, 10-106.1; see Pet. App. 4-5.

In recognition that Maryland residents' out-of-state income may be taxed by the States in which it is earned, Maryland generally grants its residents a credit against their Maryland state income-tax obligation in an amount equal to the income taxes paid to other States. Md. Tax Code § 10-703. For example, if a Maryland resident has a state-income-tax rate of 5% and earns all of his income in another State with an income-tax rate of 4%, his effective Maryland state-income-tax rate would be only 1%. Maryland does not, however, offer a similar tax credit for its county income tax. *Ibid.*; see Pet. App. 7. As a result, a Maryland resident who has paid out-of-state income taxes that exceed his Maryland state-income-tax obligation cannot apply the excess to offset the county income tax. Thus, if a Maryland resident has a state-income-tax rate of 5% and a county-income-tax rate of 2%, and earned all of his income in another State with an income-tax rate of 6%, he would not owe any state in-

come tax to Maryland, but he would still owe the 2% county income tax.

2. Respondents are a married couple. Pet. App. 8-9. In 2006, they resided in Howard County, Maryland, which had a county-income-tax rate of 3.2%. *Ibid.*; Br. in Opp. 5. Respondents owned stock in a corporation, Maxim Healthcare Services, Inc. (Maxim), that had elected to be treated as an "S corporation" under the Internal Revenue Code. Pet. App. 9. An S corporation does not pay federal income tax but instead passes through its income to its shareholders, who then pay tax on that income. See 26 U.S.C. 1366. Because Maryland has adopted the concept of an S corporation in its own tax code, it also taxes the income of such a corporation as income earned by its individual shareholders. Pet. App. 8.

In 2006, respondents earned taxable net income of $2,667,133, much of which was passed through from Maxim. Pet. App. 56. Because Maxim had earned much of its income in States other than Maryland, it had filed income-tax returns on behalf of its shareholders in 39 States. *Id.* at 9, 56. Maxim had allocated to each shareholder a pro rata portion both of its income and of the state taxes that it had paid. *Ibid.* On their 2006 Maryland income-tax return, respondents claimed a tax credit of $84,550 for income taxes paid in other States. *Id.* at 56. Petitioner denied the full amount of the tax credit, however, declining to apply it to respondents' county income tax. *Ibid.*

3. Respondents appealed the resulting tax deficiency. Pet. App. 10. The Hearings and Appeals Section of the Comptroller's Office modified the assessment slightly but otherwise affirmed. *Ibid.*

Respondents then appealed to the Maryland Tax Court, which also affirmed. Pet. App. 10, 127-139. In the tax court, respondents argued for the first time that the "limitation of the credit" to apply only to the state income tax and not to the county income tax "discriminated against interstate commerce in violation of the Commerce Clause of the United States Constitution." *Id.* at 10. This Court has interpreted the Commerce Clause—which empowers Congress to "regulate Commerce * * * among the several States," U.S. Const. Art. I, § 8, Cl. 3—to "have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." *Oregon Waste Sys., Inc.* v. *Department of Envtl. Quality*, 511 U.S. 93, 98 (1994). The Maryland Tax Court rejected respondents' Commerce Clause argument, viewing the constitutionality of the state taxing scheme as settled by binding precedent. Pet. App. 135-136.

The Circuit Court for Howard County reversed, concluding that Maryland's taxation scheme violates the Commerce Clause. Pet. App. 53-126. The circuit court concluded that, in the absence of a credit against the county income tax for "income earned and taxed out-of-state," Maryland's scheme "substantially burdens its residents conducting business in interstate commerce, as compared to those conducting purely intrastate commerce." *Id.* at 54. The court observed, *inter alia*, that if a Maryland resident earns income in a State with an income-tax rate higher than Maryland's state-income-tax rate, the resident's total tax liability (to all States) will be greater than if he had earned all of his income in Maryland (because he will pay the higher out-of-state income tax plus the entire

Maryland county income tax). *Id.* at 101-103. The circuit court remanded the case for "further factual considerations" and "an appropriate credit for out-of-State income taxes." *Id.* at 126.

4. The Court of Appeals of Maryland granted certiorari and affirmed the circuit court's decision. Pet. App. 1-49. The court recognized that, under decisions of this Court addressing the Due Process Clause, a State "may tax the income of its residents, regardless of where that income is earned." *Id.* at 3; see *id.* at 4 (citing *Chickasaw Nation*, 515 U.S. at 462-463 & n.11; *New York* v. *Graves*, 300 U.S. 308, 312-313 (1937)). The court concluded, however, that Maryland's imposition of a county income tax without a credit for out-of-state income taxes violates the Commerce Clause because it "discriminates against interstate commerce." *Id.* at 32.

The court of appeals reasoned that, because a Maryland resident will sometimes face greater total multistate tax liability if he earns out-of-state income, "[t]his creates a disincentive for the taxpayer—or the S corporation of which the taxpayer is an owner—to conduct income-generating activities in other states with income taxes." Pet. App. 16. The court also concluded that the Maryland tax scheme did not satisfy the four-part test set forth in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977), which looks to whether the state tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.* at 279; see Pet. App. 17-32. Although respondents did not contest the first (substantial-nexus) and last (fair-relation) elements of the

Complete Auto test, the court concluded that the tax did not satisfy the other two elements. Pet. App. 17-31.

Two Justices dissented. Pet. App. 36-49. The dissenters observed that respondents "live in Howard County where they benefit from the services provided by that county," and that it "'is not a purpose of the Commerce Clause to protect state residents from their own state taxes.'" *Id.* at 37 (quoting *Goldberg* v. *Sweet*, 488 U.S. 252, 266 (1989)). The dissenting Justices also recognized that States can, in some circumstances, permissibly "impose taxes that may result in some overlap in taxation of income." *Id.* at 40 (citing *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 278-279 (1978)). They emphasized that Maryland's tax system "does not expressly discriminate against interstate commerce" because the county income tax "is directed at income earned by residents of Howard County, not interstate commerce." *Id.* at 41. They also concluded that respondents had failed to prove that Maryland's system "places more than an incidental burden upon interstate commerce." *Ibid.*; see *id.* at 44-48.

5. The court of appeals denied reconsideration. Pet. App. 52. The court issued a short opinion clarifying, *inter alia*, that Maryland might avoid Commerce Clause concerns not only through tax credits but also through other methods. *Id.* at 50-52. The court of appeals granted a stay pending this Court's disposition of the petition for a writ of certiorari. *Id.* at 52.

DISCUSSION

The decision below is incorrect and warrants this Court's review. This Court has long recognized that States have plenary authority to tax the entire income, wherever earned, of their own residents, who

directly benefit from the services funded by income taxes, and who collectively have the political power to achieve the repeal of any undesirable tax laws. Although States often choose to grant tax credits to their residents for income taxes paid in other States, nothing in the Commerce Clause compels a State to offer such credits or otherwise defer to other States in the taxation of its own residents' income. The decision below has significant financial consequences for Maryland; may lead to challenges to similar tax schemes in other jurisdictions; and is inconsistent with statements made by the highest courts in other States. This case is a suitable vehicle for addressing the question presented, and this Court should grant certiorari.

A. Maryland's County Income Tax Is Constitutional

1. It is a "well-established principle of interstate and international taxation" that "a jurisdiction * * * may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Oklahoma Tax Comm'n* v. *Chickasaw Nation*, 515 U.S. 450, 462-463 (1995). "Domicil[e] itself affords a basis for such taxation" because "[e]njoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government." *Id.* at 463 (quoting *New York* v. *Graves*, 300 U.S. 308, 313 (1937)). "These are rights and privileges which attach to domicil[e] within the state," and "[n]either the privilege nor the burden is affected by the character of the source from which the income is derived." *Ibid.* (quoting *Graves*, 300 U.S. at 313).

As the Court observed nearly two centuries ago, the "people of a State * * * give to their government a right of taxing themselves and their property,

and as the exigencies of government cannot be limited, they prescribe no limits to the exercise of this right, resting confidently on the interest of the legislator, and on the influence of the constituents over their representative, to guard them against its abuse." *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316, 428 (1819).[1] In accordance with that principle, this Court has frequently rejected claims that taxes on a resident's out-of-state income violate the Due Process Clause for lack of a sufficient "connection" or "relat[ionship]," *Quill Corp.* v. *North Dakota*, 504 U.S. 298, 306, 313 (1992) (citations omitted), to the taxing State. The Court has held, for example, that a State "may tax its residents upon net income from a business whose physical assets, located wholly without the state, are beyond its taxing power," *Graves*, 300 U.S. at 313 (citing, *inter alia*, *Lawrence* v. *State Tax Comm'n*, 286 U.S. 276 (1932)); "may tax net income from bonds held in trust and administered in another state," *ibid.* (citing *Maguire* v. *Trefry*, 253 U.S. 12, 14 (1920)); and may tax the income from rental properties located in other States, *id.* at 313-316.

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[1] The *McCulloch* Court's reference to "property" is best understood as a reference to property located in the State. A State cannot necessarily tax property located out-of-state simply because its owner is a state resident. See, *e.g.*, *Safe Deposit & Trust Co.* v. *Virginia*, 280 U.S. 83, 93 (1929) ("Tangible personal property permanently located beyond the owner's domicile may not be taxed at the latter place."); *Standard Oil Co.* v. *Peck*, 342 U.S. 382, 384-385 (1952) (invalidating tax on whole value of out-of-state property of domestic corporation). Income taxation, however, operates on principles different from those that govern property taxation. See, *e.g.*, *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159, 188 (1983).

A State does not lose authority to tax its own residents' income simply because the State in which the income was earned also taxes that income. "Although sovereigns * * * sometimes elect not to" exercise their "authority to tax all income of their residents," and thus "commonly credit income taxes paid to other sovereigns," that "'is an independent policy decision and not one compelled by jurisdictional considerations.'" *Chickasaw Nation*, 515 U.S. at 463 n.12 (citation omitted). A constitutional rule requiring an automatic tax credit whenever a resident's income is subject to tax in another State would produce anomalous results. Suppose that many residents of State A, which has an income-tax rate of 4%, work (and earn all of their income) in State B. If State B has no income tax, then State A can collect the full 4% from those residents. But if the legislature of State B imposes a 2% income tax, then State A's tax collections from those residents will be halved. And if State B imposes a 4% income tax, then State A cannot collect any income tax at all from those residents unless it increases its generally-applicable income-tax rate.

It would make little sense for a State's power to collect an income tax from its own residents, in order to fund the services and protection its residents receive, to be circumscribed by the independent actions of another State with a less significant connection to those persons. The residents of State A are likely to receive considerable benefits (including schools, emergency services, utilities, and the legal protections attendant to residency) from that State, and it is the only State whose officials are politically accountable to those residents. If State A's authority to tax its residents' income were contingent on State B's taxing

decisions, then State B's officials could limit the range of options available to State A in matters of fiscal policy. In particular, any increase in State B's income-tax rate would force State A's legislators either to forgo revenue (and likely cut programs that benefit its residents) or to generate revenue in other ways (likely by increasing taxes that affect its residents). Nothing in the Constitution, and no decision of this Court, compels that result.

2. As respondents correctly explain (Br. in Opp. 13-17), this Court's decisions recognizing the States' broad authority to tax their own residents have typically addressed challenges brought under the Due Process Clause, rather than under the Commerce Clause. Respondents identify no decision of this Court, however, holding that the Commerce Clause effectively subjugates a State's "ordinary prerogative to tax the income of every resident," *Chickasaw Nation*, 515 U.S. at 464, to a right of first refusal by the State in which the income is earned. Income taxes have long been "a recognized method of distributing the burdens of government, favored because [they] requir[e] contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax may be readily proportioned to their ability to pay." *Shaffer* v. *Carter*, 252 U.S. 37, 51 (1920). "Taxes of this character were imposed by several of the States at or shortly after the adoption of the Federal Constitution." *Ibid.* The States did not likely intend, in ratifying a Constitution that granted Congress the exclusive authority to regulate interstate commerce, to limit their own sovereign authority to impose income taxes on their own residents. Chief Justice Marshall, "speaking for the

[C]ourt" in *McCulloch*, explained "that the States have full power to tax their own people and their own property." *Ibid.*; see *McCulloch*, 17 U.S. (4 Wheat.) at 428-429 (finding it "almost * * * self-evident" that "[a]ll subjects over which the sovereign power of a State extends, are objects of taxation").

If the Commerce Clause limited a State's authority to tax the income of its own residents, as the Maryland Court of Appeals believed, then a longstanding and significant principle of this Court's state-taxation jurisprudence would be a virtual dead letter. In *Fidelity & Columbia Trust Co.* v. *City of Louisville*, 245 U.S. 54 (1917), for example, this Court held that a city in Kentucky could tax bank deposits belonging to one of its residents, notwithstanding that the deposits represented the proceeds of a Missouri business and were held in a Missouri bank. *Id.* at 57-60. Although the Court accepted that "the Missouri deposits could have been taxed in that State," it explained that "liability to taxation in one State does not necessarily exclude liability in another." *Id.* at 58. On respondents' theory, however, the taxpayer could have asserted under the Commerce Clause a valid objection to the imposition of tax by Kentucky (or at least could have claimed a credit for the Missouri taxes if the Kentucky taxes were higher). Recognizing such a right under the Commerce Clause would effectively nullify the Court's Due Process Clause holding. See also *Guaranty Trust Co.* v. *Virginia*, 305 U.S. 19, 22-23 (1938) (concluding that the Due Process and Equal Protection Clauses permitted "imposing two State taxes on the same income," where a New York trust paid taxes on income in New York and a Virginia beneficiary paid taxes on distributions in Virginia).

3. The "modern law of what has come to be called the dormant Commerce Clause is driven by concern about 'economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.'" *Department of Revenue* v. *Davis*, 553 U.S. 328, 337-338 (2008) (quoting *New Energy Co.* v. *Limbach*, 486 U.S. 269, 273-274 (1988)). The court below analyzed Maryland's taxation system under the four-part test set forth in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977). See Pet. App. 17-32. Under that test, a state tax is consistent with the Commerce Clause so long as it "is applied to an activity with a substantial nexus with the taxing State," "is fairly related to the services provided by the State," "does not discriminate against interstate commerce," and "is fairly apportioned." *Complete Auto*, 430 U.S. at 279.

It is far from clear that the *Complete Auto* test should apply to a State's taxation of its own residents' income. See, *e.g.*, Pet. App. 41 n.2 (Greene, J., dissenting) (observing that, "[i]n most of the cases where the Supreme Court has subjected a tax to the *Complete Auto* test, the tax was directly on interstate commerce itself or items in interstate commerce"). Assuming *arguendo* that the *Complete Auto* test applies, however, Maryland's county income tax satisfies that test, even if Maryland declines to credit out-of-state income taxes against the county tax. Respondents have not disputed that "application of the county tax in this case has a substantial nexus to Maryland or that it is fairly related to services provided by the State." *Id.* at 17-18. And, contrary to the state court of appeals' conclusion (*id.* at 17-32), the county income tax "does not discriminate against interstate com-

merce" and is "fairly apportioned." *Complete Auto*, 430 U.S. at 279.

Discrimination against interstate commerce. This Court has consistently distinguished laws that "regulate[] evenhandedly with only 'incidental' effects on interstate commerce" from those that "discriminate[] against interstate commerce." *Hughes* v. *Oklahoma*, 441 U.S. 322, 336 (1979); see, *e.g.*, *United Haulers Ass'n, Inc.* v. *Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 334 (2007). Maryland's county income tax falls into the former category. It treats all residents of a particular county—whether they earn income in-state or out-of-state—"exactly the same," assessing a tax on each of them at an identical fixed rate. See *id.* at 345 (concluding that certain ordinances, "which treat in-state private business interests exactly the same as out-of-state ones, do not 'discriminate against interstate commerce' for purposes of the dormant Commerce Clause"); see Md. Tax Code §§ 10-103, 10-106; see also Pet. App. 41 (Greene, J., dissenting) (noting that Maryland's county income tax "does not expressly discriminate against interstate commerce"). The tax also lacks any evident protectionist purpose.

The state court of appeals believed that Maryland's income-tax system discriminated against interstate commerce because, in the absence of a credit against the county income tax for income taxes paid to other States, Maryland residents may sometimes pay higher total (in-state plus out-of-state) taxes on out-of-state income than on in-state income. See Pet. App. 30. It is true that a "finding that state legislation constitutes 'economic protectionism' may be made on the basis of either discriminatory purpose or discriminatory ef-

fect." *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 270 (1984) (citation omitted). But the possibility that a state resident's multistate tax bill will be higher if he earns income out-of-state (and thus is subject to taxation by multiple States) is not in itself a cognizable discriminatory effect under the Commerce Clause. See *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 277 n.12 (1978) (finding no "discriminat[ion] against interstate commerce" where higher taxes were "the consequence of the combined effect" of two different States' statutes). The higher tax bill is no more attributable to Maryland than it is to the other State or States that are taxing the resident's income. See *ibid.*

If it were considered discriminatory to adopt a tax scheme under which residents have a financial incentive to earn income in-state, then any number of state taxation systems would be constitutionally infirm. Suppose, for example, that a State assesses no income tax on its residents, but requires them to pay a property tax or a flat-fee residence tax. The residents of that State will inevitably have higher total tax bills if they earn income in another State that has an income tax (and thus pay both that income tax and the local property or residence tax) than if they earn income locally (and thus pay only the local property or residence tax). Respondents do not contend, however, that state residents are entitled to a credit against their local property taxes for the income taxes they pay in other States. See Br. in Opp. 23 (suggesting that Maryland can replace its current system with increased property taxes).

The Framers could not have contemplated that the Commerce Clause would require *every* resident-specific state tax to give way to the non-resident income

taxes imposed by other States. And even if every State credited its residents for taxes paid in other States, that would not eliminate the potential for out-of-state income to be taxed at a higher rate than in-state income. If State A has an income-tax rate of 5% and State B has an income-tax rate of 7%, then even with a full tax credit from State A, residents of State A will be taxed more on income they earn in State B than on income they earn in State A. To achieve complete equality of taxation between in-state and out-of-state income, it would be necessary for every State to adopt an identical system of taxation. The Commerce Clause, however, leaves to Congress the decision whether to prescribe such a uniform national code; it does not in itself impose one. See *Moorman Mfg.*, 437 U.S. at 279-280.

Fair apportionment. The "central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg* v. *Sweet*, 488 U.S. 252, 260-261 (1989). "[W]here taxation of income from interstate business is in issue, apportionment disputes have often centered around specific formulas for slicing a taxable pie among several States in which the taxpayer's activities contributed to taxable value." *Oklahoma Tax Comm'n* v. *Jefferson Lines, Inc.*, 514 U.S. 175, 186 (1995). The Court has held, for example, that under fair-apportionment principles, California cannot apply a tax (of 5.5%) to all of an out-of-state corporation's income, but can apply the tax only to the fraction of the corporation's income that represents a rough approximation of the "value * * * generated" in California. *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159, 164, 175 n.12, 183 (1983). The size of that

"slic[e]" of the "taxable pie," *Jefferson Lines*, 514 U.S. at 186, does not depend on whether other States actually impose taxes on the remainder of the taxpayer's income. See, *e.g.*, *Armco Inc.* v. *Hardesty*, 467 U.S. 638, 644-645 (1984).

Respondents do not contend that, whenever a Maryland resident earns income in other States, Maryland may tax only a fixed portion of that income. Such a rule would saddle Maryland (and the other States) with the infeasible task of making an apples-to-oranges comparison—between the strength of Maryland's interest in taxing such income based on the recipient's residence and the strength of another State's interest in taxing the income based on the place where it was earned—in order to decide how much of the "taxable pie" is fairly allocable to Maryland.[2] Such a rule would also mean that some percentage of a Maryland resident's out-of-state income is beyond Maryland's power to tax *even if* the State in

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[2] This case does not present any question about the Commerce Clause implications of a State directly taxing the income of a domestic corporation. In such a circumstance, apportionment would not necessarily be infeasible. See, *e.g.*, *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U.S. 653, 663 (1948) (holding that New York could tax only the portion of a domestic corporation's gross income from sale of interstate bus tickets that reflected miles traveled in New York). Because a State's relationship to a domestic corporation is fundamentally economic in nature, its interest in taxing the corporation's income need not be considered qualitatively different in character from the interest of other States in taxing the same income. The relationship between an *individual* resident and the State in which he resides, however, is unique and different in kind from the relationship between that resident and a State in which he merely earns income. See, *e.g.*, *Chickasaw Nation*, 515 U.S. at 463-464 & n.11.

which the income is earned does not impose any tax upon it.

Although the court below purported to apply the judicial tests that this Court has employed in the fair-apportionment context (see Pet. App. 17-27), it did not identify any specific portion of Maryland residents' out-of-state income as being categorically beyond Maryland's authority to tax. Rather, the court appeared to accept that every dollar earned by a Maryland resident, including dollars earned through out-of-state activity, may be taxed in full by Maryland and its counties *unless* the State in which the income is earned imposes its own tax upon that income. The constitutional infirmity that the court perceived lay in the failure of Maryland's counties to provide a credit for out-of-state taxes actually imposed and paid on Maryland residents' out-of-state income. See, *e.g.*, *id.* at 30 ("[T]he failure to allow a credit is at the heart of the discrimination in this case."); *id.* at 34 ("What is unconstitutional is the application—or lack thereof—of the credit to the county income tax."). That rationale, which makes the taxing authority of Maryland and its counties contingent on taxing decisions of other States, cannot be reconciled with this Court's dormant Commerce Clause jurisprudence. See *Armco*, 467 U.S. at 644-645 (rejecting approach under which "the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax codes of 49 other States").

For reasons already discussed, see pp. 13-15, *supra*, a tax scheme does not violate the Commerce Clause simply because residents may pay less overall in taxes if they earn income locally. Because a resident who believes that his taxes are unfair can "com-

plain about and change the tax through the [state] political process," it "is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Goldberg*, 488 U.S. at 266.

B. The Question Presented Warrants This Court's Review

1. The court below resolved a question of exceptional importance to Maryland, and its decision should be reviewed by this Court. The petition explains (at 15) that, if the decision below is permitted to stand, Maryland's income-tax revenue will be reduced by an estimated $45 million to $50 million per year. In addition, residents could file retroactive tax-refund claims seeking as much as $120 million. *Ibid.* Respondents suggest (Br. in Opp. 23) that the Maryland legislature could mitigate the effect of the decision by, for example, raising the overall tax rate. As respondents recognize (*ibid.*), however, "[s]uch increases may prove locally unpopular." Before Maryland is forced to take such measures, this Court should address whether the court below erred in invalidating the taxation scheme that Maryland's representatives enacted and that Maryland has long applied.

That is particularly so because the body of this Court's precedents gave Maryland ample reason to believe that its taxing scheme was constitutional. In *Chickasaw Nation*, this Court summarized its prior decisions by asserting without qualification that a State "may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." 515 U.S. at 462-463. The Court recognized that, "[a]lthough sovereigns have authority to tax all income of their residents, including income earned outside their borders, they sometimes elect not to do so, and they commonly credit income taxes paid to other sover-

eigns." *Id.* at 463 n.12. It stated, however, that "if foreign income of a domiciliary taxpayer is exempted, this is an independent policy decision and not one compelled by jurisdictional considerations." *Ibid.* (quoting Am. Law Inst., *Federal Income Tax Project: International Aspects of United States Income Taxation* 6 (1987)) (brackets omitted).

To be sure, the Court in *Chickasaw Nation*, and in the prior decisions cited in that opinion, was not confronted with a challenge premised on the dormant Commerce Clause. In articulating the applicable constitutional rule, however, the Court has not simply stated that particular constitutional provisions (such as the Due Process Clause) do not limit a State's power to tax its residents' income. Rather, it has described the power to tax all such income as an affirmative aspect of state sovereignty. See, *e.g.*, *Shaffer*, 252 U.S. at 57 ("As to residents [a State] may, and does, exert its taxing power over their income from all sources, whether within or without the State."). The practical effect of the decision below therefore is to prevent Maryland from fully exercising a power that the State had good reason to believe it possessed.

The question presented also appears to have importance beyond its effect on Maryland. Respondents do not dispute the existence of more than 2000 municipal income taxes nationwide that might not provide credits for out-of-state income taxes. Br. in Opp. 26-27; see Pet. 15-16; Int'l Mun. Lawyers Ass'n Amicus Br. 14-18. Because "a municipality is merely a political subdivision of the State from which its authority derives," *United Bldg. & Constr. Trades Council* v. *Mayor & Council of Camden*, 465 U.S. 208, 215 (1984), those municipal taxes could be invalidated if courts in

the relevant jurisdictions find the reasoning of the decision below persuasive. Before the court below issued its ruling, state courts addressing issues similar (though not identical) to the question presented here had strongly suggested that a tax system of this sort would be consistent with the Commerce Clause. See *Tamagni* v. *Tax Appeals Tribunal*, 695 N.E.2d 1125, 1134 (N.Y.) (reasoning that "dormant Commerce Clause analysis" is "inapplicab[le] * * * to State resident income taxation"), cert. denied, 525 U.S. 931 (1998); *Keller* v. *Department of Revenue*, 872 P.2d 414, 416 (Or. 1994) (reasoning that *Complete Auto* does not "alter the rule" that a "state's taxing authority extends to all of the income earned by its residents, including income earned outside the state"). The uncertainty created by the decision below, together with the possibility that similar tax schemes might be deemed constitutional in some jurisdictions but not in others, provides additional reason for this Court's review.

2. This case is a suitable vehicle for resolving the question presented. This Court has jurisdiction under 28 U.S.C. 1257(a), notwithstanding the fact that the decision below contemplates further proceedings on remand to determine the precise amount of respondents' tax liability, see Pet. App. 34. Although Section 1257(a) authorizes review only of "[f]inal judgments or decrees," this Court has long recognized that its jurisdiction encompasses cases "in which [a] federal issue, finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings." *Cox Broad. Corp.* v. *Cohn*, 420 U.S. 469, 480 (1975); see Stephen M. Shapiro et al., *Supreme Court Practice*

165-166 (10th ed. 2013). In this case, the question whether Maryland may collect the entire county income tax will persist, regardless of the precise tax liability computed on remand.

For reasons explained in the reply brief in support of the petition (at 3-5), the question presented was "pressed or passed upon below." *United States* v. *Williams*, 504 U.S. 36, 41 (1992); cf. *Yee* v. *City of Escondido*, 503 U.S. 519, 535 (1992) ("A litigant seeking review in this Court of a claim properly raised in the lower courts * * * generally possesses the ability to frame the question to be decided in any way he chooses, without being limited to the manner in which the question was framed below."). The issues are largely legal in nature, are clearly defined, and do not require any additional factual development. In light of the immediate impact of the decision below on the sovereign interests and fiscal solvency of Maryland, there is no sound reason to delay review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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AMICUS CURIAE BRIEF

RECORD
AND
BRIEFS

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No. 13-485

In the Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, et ux.,
Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF THE INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION, THE UNITED STATES CONFERENCE OF MAYORS, THE NATIONAL ASSOCIATION OF COUNTIES, THE INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION AND THE MARYLAND ASSOCIATION OF COUNTIES AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Does the United States Constitution prohibit a state from taxing all the income of its residents—wherever earned—by mandating a credit for taxes paid on income earned in other states?

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Valentino v. Franchise Tax Bd.,
105 Cal. Rptr. 2d 304 (Cal. Ct. App. 2001) 8

OTHER AUTHORITY

Hellerstein, State Taxation: 3rd Edition,
¶ 20.10[2][b] 7

INTEREST OF *AMICI CURIAE*[1]

The International Municipal Lawyers Association (IMLA) is a non-profit, nonpartisan professional organization consisting of more than 2500 members. The membership is comprised of local government entities, including cities, counties and subdivisions thereof, as represented by their chief legal officers, state municipal leagues, and individual attorneys. IMLA serves as an international clearinghouse of legal information and cooperation on municipal legal matters. Established in 1935, IMLA is the oldest and largest association of attorneys representing United States municipalities, counties and special districts.

IMLA's mission is to advance the responsible development of municipal law through education and advocacy by providing the collective viewpoint of local governments around the country on legal issues before the United States Supreme Court, the Unites States Courts of Appeals, and in state supreme and appellate courts.

The United States Conference of Mayors (USCM), founded in 1932, is the official nonpartisan organization of all United States cities with a population of more than 30,000 people, which includes

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[1] No counsel for any party to these proceedings authored this brief, in whole or in part. No entity or person, aside from *amici* or their members, paid for or made any monetary contribution toward the preparation or submission of this brief. *Amici curiae* file this brief with the written consent of all parties, copies of which are on file with the Clerk's Office. All parties received timely notice of *amici*'s intent to file this brief.

over 1,200 cities at present. Each city is represented in the USCM by its chief elected official, the mayor.

The National Association of Counties (NACo) is the only national organization that represents county governments in the United States. NACo provides essential services to the Nation's 3,068 counties through advocacy, education, and research.

The International City/County Management Association (ICMA) is a nonprofit professional and educational organization of over 9,000 appointed chief executives and assistants serving cities, counties, towns, and regional entities. ICMA's mission is to create excellence in local governance by advocating and developing the professional management of local governments throughout the world.

The Maryland Association of Counties (MACo) is a non-profit and non-partisan organization that serves Maryland's 23 Counties and Baltimore City by articulating the needs of local government to the Maryland General Assembly. Although MACo does not regularly advocate in the courts, it has chosen to make an exception in this case because of the acute ramifications of the Court of Appeals' decision on MACo's member jurisdictions. Specifically, as a result of the ruling, each of Maryland's counties and Baltimore City will experience significant reductions in personal income tax collections and be hindered in their ability to provide critical public infrastructure and services to residents such as schools, roads, police, parks, and libraries, to name only a few. Based on recent estimates from the State Comptroller's Office, the retroactive effect of this decision could potentially be $120 million in lost local income tax revenues.

Prospectively, the effect could reduce local income tax revenues by $45 million to $50 million annually.

The *amici* respectfully submit this brief on behalf of the thousands of state subdivisions—counties, cities, townships and other municipalities—that operate under our system of federalism to collect local income taxes that fund their provision of vital services to residents. The implications of the Maryland Court of Appeals' ruling for many of those municipalities is dire: if every state is required to accord its residents a dollar-for-dollar credit for all income taxes paid to out of state recipients (including counties and cities in other states), the flow of funds to in-state municipalities will be vastly curtailed. There are many states with long-established tax programs that, like Maryland's, do not afford dollar-for-dollar credits to residents for all out-of-state income taxes paid and are operating on a premise of constitutional viability.

Additionally, the *amici* believe that this Court should resolve the conflict created by the Maryland Court of Appeals between a most basic principle of state sovereignty – the right of a state to tax a person resident within its boundaries, which has been recognized throughout the history of this Court–and the unwritten, amorphous and arbitrary concept of "dormant" Commerce Clause jurisprudence.

SUMMARY OF ARGUMENT

The Court should grant certiorari in this case because the Maryland Court of Appeals' decision conflicts with other state court decisions and because this is an important issue of federalism that has not been authoritatively decided by this Court. This case

places before the Court the important question of whether a state may tax all the income of its residents, wherever earned, or whether it is constitutionally mandated to provide a dollar-for-dollar credit for all income taxes paid by those residents in other states.

At issue is the degree to which individual states may exercise their sovereign prerogative to raise revenues. If the Court of Appeals is correct, the dormant Commerce Clause requires that states and their subdivisions re-write their tax codes and continue to provide essential services to residents who may pay little or nothing for them.

Historically, this Court has recognized a State's unlimited authority to tax its residents provided the tax is on property within the state or on privileges enjoyed there. *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 279-80 (1932). No one can argue that the taxpayer in this case enjoyed only limited privileges in his home county. In 2010, Money Magazine rated Columbia/Ellicott City (Howard County's main population center) the second best place to live among America's small cities.[2] The County's library system ranks as one of the best in the nation and the County has received numerous other accolades for its services.[3] These awards reflect the County's commitment to excellence—and its taxpayers' willingness to spend the funds needed to achieve that excellence. All of those

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[2] http://money.cnn.com/magazines/moneymag/bplive/2010/snapshots/PL2419125.html (last accessed November 14, 2013).

[3] http://www.co.ho.md.us/exec.aspx?id=6442458795 (last accessed November 14, 2013).

funds derive from the County's multiple sources of tax revenues including its income tax.

The decision by the Maryland Court of Appeals departs from this foundation and is instead based on different principles:

1. First, in order to avoid substantial interference in interstate commerce, the dormant Commerce Clause of the United States Constitution *requires* every state and subdivision thereof to give its residents a full tax credit for all income taxes paid in another state or subdivision; and

2. Second, the receipt of Subchapter S pass-through income in Maryland is "interstate commerce" which is being substantially affected by Maryland's tax structure, in violation of the dormant Commerce Clause.

Although this Court has repeatedly confirmed that a State may tax income of its residents without regard to source, the specific question of whether a State must offer a credit to its residents for all income taxes paid to another jurisdiction has never been decided.

The constitutional principle relied on by the Maryland Court of Appeals—the dormant Commerce Clause—is not the bright-line mandate discerned by that court. Cases below and the Court's own precedents assessing tax issues in light of the dormant Commerce Clause lead to divergent conclusions. While traditional dormant Commerce Clause analyses function effectively in cases where a state has clearly acted, typically as a market regulator, to favor in-state competitors, the analysis in the arena of state and local personal income taxation where the taxation is not

facially discriminatory is more nuanced and defies doctrinal answers.

The decision by the Court of Appeals implies that any state whose tax code does not grant a full credit for all income taxes paid by residents to other jurisdictions is void *ab initio*. In the case of Maryland, says the Court of Appeals, this discontinuity stifles interstate commerce and requires dismantling of the state's income tax structure. The many other states and local governments that decline to give full credit for all income taxes paid in other jurisdictions will face the same imperative.

This result is inconsistent with state sovereignty and is not mandated by the Constitution.

REASONS FOR GRANTING THE PETITION

This Court should grant certiorari to settle what has become a murky area of the law pitting the decision of the Maryland Court of Appeals against decisions of courts in other states and resolving the important federal question of the extent to which the dormant Commerce Clause should chip away at a State's most basic sovereign power: that of taxing its residents.

Left unchecked, the implication that any state tax program is unconstitutional which does not grant a dollar-for-dollar credit against in-state income taxes for out-of-state income taxes paid, could result in an attack on many state and municipal tax laws across the nation. This Court should avert such an assault.

ARGUMENT

I. THE DECISION OF THE MARYLAND COURT OF APPEALS IS NOT MANDATED BY THE CONSTITUTION AND CONFLICTS WITH NUMEROUS CONTRARY HOLDINGS IN OTHER STATES

The conclusion of the Court of Appeals that a state must, under the imperatives of the dormant Commerce Clause, grant its residents a complete tax credit for every dollar of income tax paid to another state is not mandated by the Constitution. The Maryland court does not cite a single precedent for the proposition that the United States Constitution unambiguously *requires* every state to grant a full credit to its residents for all income taxes they may pay to every other state. The reason for this void is that there is no such case. As Professor Hellerstein, often cited by this Court and many courts around the country, states: "The question then arises as to whether the Commerce Clause requires Resident State nevertheless to grant a credit for taxes that Source State has permissibly imposed in order to avoid the resulting risk, if not actuality, of multiple taxation. ***The answer to this question is by no means clear . . . .*** " *Hellerstein*, State Taxation: 3rd Edition, ¶ 20.10[2][b] (emphasis added).

The ambiguity surrounding this issue is even more apparent when the holding of the Maryland Court of Appeals is reviewed in the context of out-of-state tax credit decisions in other jurisdictions. For example, New York's highest court has expressly found that an individual taxpayer residing in one state who is disallowed a tax credit for income taxes paid in another state does NOT implicate interstate commerce or the

dormant Commerce Clause. *Tamagni v. Tax Appeals Tribunal,* 695 N.E.2d 1125 (N.Y. 1998). As the court said there, "[t]he New York income tax operates to tax residents as residents of this State, without regard to their activities in other states; so long as this State's definition of resident does not violate due process (and there is no claim here that it does), no violation of the dormant Commerce Clause is apparent." *Id.* at 1134. Similarly, the Supreme Court of Connecticut has held that the dormant Commerce Clause does not invalidate Connecticut's failure to allow a credit for income taxes paid out of state. *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 805 (Conn. 1999). In *Christman v. Franchise Tax Bd.*, 134 Cal. Rptr. 725, 732 (Cal. Ct. App. 1976) the California Court of Appeals upheld that state's denial of a credit for income taxes paid by a California resident on Subchapter S income generated in Georgia.[4] Likewise in *Boone v. Chumley*, 372 S.W.3d 104, 111-12 (Tenn. Ct. App. 2011), the Tennessee Court of Appeals upheld a denial of credit for Tennessee residents who paid taxes to South Carolina on Subchapter S income and held that Tennessee's refusal to provide a credit did not violate the dormant Commerce Clause. As the foregoing demonstrates, "[n]either the federal nor state constitutions require a

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[4] *Christman* was decided before California recognized S corporation status, the corporation was a C corporation for California purposes, and the court regarded the income in issue as dividends. *Valentino v. Franchise Tax Bd.,* 105 Cal. Rptr. 2d 304, 306-07 (Cal. Ct. App. 2001), distinguished *Christman* on this ground under California tax law, but the decision in *Christman* construing the dormant Commerce Clause's effect upon the state's duty to grant tax credits continues in stark contrast to the decision of the Maryland Court of Appeals.

state to provide an income tax credit for income taxed by a foreign jurisdiction" but that rather, a "[c]redit is a matter of grace and a state may impose conditions on its application." *Laurite v. Director, Div. of Taxation*, 12 N.J. Tax 483, 492 (1992).

This Court, too, has previously discussed the dormant Commerce Clause *vis a vis* a state's income tax scheme. Addressing the State of Mississippi's income tax on the income of a resident who earned income in Tennessee, the Court recognized the authority of the State to tax out-of-state income and gave convincing support for doing so:

> The obligation of one domiciled within a state to pay taxes there, arises from unilateral action of the state government in the exercise of the most plenary of sovereign powers, that to raise revenue to defray the expenses of government and to distribute its burdens equably among those who enjoy its benefits. Hence, domicile in itself establishes a basis for taxation. Enjoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government. *See Fidelity & Columbia Trust Co. v. Louisville*, 245 U.S. 54, 58; *Maguire v. Trefry*, 253 U.S. 12, 14, 17; *Kirtland v. Hotchkiss*, 100 U.S. 491, 498; *Shaffer v. Carter*, 252 U.S. 37, 50.
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> The Federal Constitution imposes on the states no particular modes of taxation, and apart from the specific grant to the federal government of the exclusive power to levy certain limited classes of taxes and to regulate interstate and

> foreign commerce, it leaves the states unrestricted in their power to tax those domiciled within them, so long as the tax imposed is upon property within the state or on privileges enjoyed there, and is not so palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment. *Kirtland v Hotchkiss*, *supra*.

Lawrence v. State Tax Comm'n, 286 U.S. 276, 279-80 (1932).

By way of amplifying the *Lawrence* Court's acknowledgement that a state has unrestricted power to tax those domiciled within the state *"so long as the tax imposed is . . . on privileges enjoyed there,"* the Howard County, Maryland Budget[5] helps explain the importance of the local income tax to its ability to provide services to its residents. For FY 2014, the income tax makes up 23.36% of its revenues. Applied to a budget of almost $1.6 Billion, the income tax amounts to about $373 Million. These revenues fund a host of privileges enjoyed by the taxpayers. What privileges do these revenues fund? In the FY 2014 Budget, the expenditures are divided up among various broadly defined programs with education being the greatest recipient of funding: roughly 57% of the total budget. In the case before the Court, the taxpayer has five school age children, all of whom could be enjoying these privileges. The taxpayer also enjoys a commitment to public safety - 13% of the budget; public

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[5] The Howard County Budget for FY 2014 is available through the County's website at: http://www.howardcountymd.gov/departments.aspx?ID=499 (last accessed November 13, 2013).

facilities – 10% of the budget; a legislative and judicial system – 1% of the budget; community services – 5% of the budget and so on. That the resident taxpayer in this case enjoys the foregoing privileges provided by Howard County is self-evident. The role played by local income taxes is even greater in other Maryland counties.[6]

Regardless of where a resident's income originates, that income forms the basis of taxation generally used to fund public services. Clearly, some residents are taxed for services that they do not use – seniors do not generally use the educational system; while younger families rely less on some community services than do older residents. Nevertheless, despite the lack of direct nexus between a tax and particular services rendered, local taxes find constitutional support if their nexus lies in the common privileges they fund for all resident taxpayers. The Maryland Court of Appeals' decision drifts from this long-standing principle. It conflates

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[6] For example, in Montgomery County, Maryland, the income tax accounts for nearly 29% of the County's revenue stream and will amount to an estimated $1.299 Billion in FY 14. Like Howard County, Montgomery County uses these revenues for a host of projects, among them the provision of affordable housing; solving traffic congestion; serving the educational needs of over 151,000 K-12 students; addressing storm water management failures in its MS4 systems; and increasing by 120 the number of police officers serving the community. *See* Montgomery County Revenue Schedule for FY 14, available at: http://www.montgomerycountymd.gov/OMB/Resources/Files/omb/pdfs/fy14/psp_pdf/schedc.pdf (last accessed November 15, 2013). Highlights of the County's FY14 Budget are available at: http://www.montgomerycountymd.gov/OMB/Resources/Files/omb/pdfs/fy14/psp_pdf/psp_highlights.pdf (last accessed November 14, 2013).

the dormant Commerce Clause jurisprudence following *Complete Auto,* a decision that involves franchise taxes–taxes specifically imposed for the privilege of doing business in the state, with the individual income tax–a tax on residents' income from whatever source. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Indeed, the Court in *Complete Auto* affirms the basic principles set out in *Lawrence*, that a tax on the privileges enjoyed by a resident taxpayer are not subject to invalidation under the dormant Commerce Clause. *Id.* at 278-80.

II. THE DECISION OF THE MARYLAND COURT OF APPEALS UNDERMINES STATE SOVEREIGNTY

The decision of the Maryland Court of Appeals obstructs the State's power of taxation, a fundamental incident of State sovereignty recognized since the time of *McCulloch v. Maryland*, 17 U.S. 316 (1819) that unambiguously permits a state to tax *all* the income of its residents wherever derived. *Oklahoma Tax Comm'n v. Chicasaw Nation,* 515 U.S. 450, 453 (1995).[7]

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[7] In *Chickasaw Nation*, the Court noted:

> Although sovereigns have authority to tax all income of their residents, including income earned outside their borders, they sometimes elect not to do so, and they commonly credit income taxes paid to other sovereigns. But "if foreign income of a domiciliary taxpayer is exempted, this is an independent policy decision and not

In requiring that states grant credits for all income taxes paid out-of-state, the court undermines the prerogative of states and their subdivisions to enact a diversity of mechanisms and structures that collect revenues sufficient to provide the public services for which they are responsible. *See Shaffer v. Carter*, 252 U.S. 37, 50-51 (1920).

If a policy is to be effected requiring every state in the nation to credit income taxes paid by residents to every other state, such action should come from Congress itself. Otherwise, deference to state sovereignty requires that some discontinuities survive. This Court has previously confirmed, in a decision rendered after *Complete Auto*, that the dormant Commerce Clause does not definitively prohibit all overlap in taxation in income:

> The only conceivable constitutional basis for invalidating the Iowa statute would be that the Commerce Clause prohibits any overlap in the computation of taxable income by the States. If the Constitution were read to mandate such precision in interstate taxation, the consequences would extend far beyond this particular case. *For some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income.* Accepting

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one compelled by jurisdictional considerations." American Law Institute, Federal Income Tax Project: International Aspects of United States Income Taxation 6 (1987).

Oklahoma Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 463, n. 12 (U.S. 1995).

> appellant's view of the Constitution, therefore, would require extensive judicial lawmaking.

Moorman Mfg. Co. v. Bair, 437 U.S. 267, 278-79 (1978). (emphasis added).

This Court was abundantly clear that, notwithstanding Commerce Clause considerations, any move to enforce a more uniform system of interstate taxation on the States must come from Congress:

> While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to the interests of all affected States. It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.

Id. at 280.

The far-reaching implications of the decision of the Maryland Court of Appeals on state sovereignty are not hypothetical. While seven states have chosen not to tax personal income at all, the remaining forty-three states and the District of Columbia levy a tax on personal income. So do nearly 5,000 state subdivisions—counties, cities and special districts around the country, many of which are IMLA

members.[8] Each of Maryland's counties assesses an income tax, at rates from 1.25% to 3.2%.[9] So too do Indiana's 92 counties, assessing income taxes at rates up to 3.13%.[10] In Ohio, 593 municipalities and 181 school districts assess such a tax,[11] as do 2,469 municipalities and 469 school districts in Pennsylvania.[12]. Many cities and school districts in Iowa and Michigan also assess these taxes.[13] Major cities frequently charge income taxes; Philadelphia's income tax is 3.928% on residents and 3.4985% on non-residents.[14]

These municipalities have enacted statutes to collect taxes from individuals and businesses, whether resident or non-resident, which generate revenues and income within their boundaries and thereby benefit from the governmental infrastructure which allows such activity to flourish. Local jurisdictions have the

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[8] http://taxfoundation.org/article/local-income-taxes-city-and-county-level-income-and-wage-taxes-continue-wane (last accessed November 10, 2013).

[9] http://taxes.marylandtaxes.com/Individual_Taxes/Individual_Tax_Types/Income_Tax/Tax_Information/Tax_Rates/Local_and_County_Tax_Rates.shtml (last accessed November 14, 2013).

[10] http://www.in.gov/dor/files/dn01.pdf (last accessed November 9, 2013).

[11] Tax Foundation, *supra* note 8.

[12] *Id.*

[13] *Id.*

[14] *Id.*

burden of providing these residents a multitude of services including police and fire protection, schools, roads, water, trash collection, building inspection, land use zoning and planning, and the promotion of culture and entertainment. The prerogative of states to authorize a diversity of taxing mechanisms to fund these benefits is unquestioned. *Shaffer*, 252 U.S. at 50-51.

The mischief inherent in the Maryland Court of Appeals' decision arises from the fact that ***many states and municipalities do not grant a complete credit to their residents for all income taxes paid in other jurisdictions.*** These include Wisconsin and North Carolina, which *expressly disallow* credits for city, county and other local income taxes paid out of state.[15] Likewise, the Tennessee Court of Appeals recently upheld the denial of a credit for income taxes paid to South Carolina by a Tennessee resident on Subchapter S income, reasoning that Tennessee and South Carolina did not have tax reciprocity. *Boone v. Chumley*, 372 S.W.3d 104, 108-11 (Tenn. Ct. App. 2011). The court held that it would not imply a reciprocity agreement between the two states because it did "not believe the General Assembly intended to enact a reciprocal agreement with a sister state *under which Tennessee could not receive a reciprocal benefit.*" *Id.* at 108 (emphasis in original).

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[15] Wisconsin expressly disallows a credit for income taxes paid to a county in another state. http://www.revenue.wi.gov/pubs/pb125.pdf (last accessed November 9, 2013); so does North Carolina http://www.dornc.com/taxes/individual/another.html (last accessed November 14, 2013).

In addition to some states declining to grant income tax credits, many municipalities impose a tax on residents without allowing a credit for taxes paid out of state (though some do allow a credit for taxes paid to another municipality), including Philadelphia, Cleveland, Detroit, Indiana's counties, Kansas City, St. Louis, and Wilmington.[16] As Philadelphia's income tax web site explains:

> The Earnings Tax is a tax on salaries, wages, commissions and other compensation paid to an employee who is employed or renders services to an employer. The City of Philadelphia is not a party to any reciprocal tax agreements with any other municipality. Non-residents of Pennsylvania cannot claim a tax credit against Philadelphia Earnings Tax for income taxes paid to any other state or political subdivision. Residents of Philadelphia employed outside of Pennsylvania may be required to file and pay a

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[16] *See* http://www.ccatax.ci.cleveland.oh.us/Y2013/muniit.pdf (last accessed November 11, 2013); http://www.legislature.mi.gov/(S(mphllz55322neouolpmmk2ik))/mileg.aspx?page=getobject&objectname=mcl-284-1964-2 (last accessed November 11, 2013); http://www.in.gov/dor/reference/files/ib32.pdf (last accessed November 11, 2013); http://kcmo.org/idc/groups/finance/documents/finance/rd-109.pdf; http://www.slpl.lib.mo.us/cco/code/data/t0522.htm (last accessed November 11, 2013); http://www.wilmingtonde.gov/government/earnedincometax (last accessed November 11, 2013); http://www.phila.gov/Revenue/businesses/taxes/Pages/WageTax.aspx (last accessed November 11, 2013).

local income tax in that jurisdiction *in addition to* Philadelphia Earnings Tax.[17]

This discontinuity is by no means limited to income taxes. For example, other states disallow deductions for gross receipts taxes paid out of state.[18]

These statutes may result in double taxation. Under the rationale of the Court of Appeals, such discontinuities, inherent in a diverse matrix of state and local taxing initiatives, must be challenged. The implications of the Maryland decision for state and local sovereignty are sobering: Every taxpayer of every description in states that do not allow full credit for

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[17] http://www.phila.gov/Revenue/individuals/taxes/Pages/EarningsTax.aspx (last accessed November 11, 2103) (emphasis added).

[18] Massachusetts expressly disallows credits for gross receipts taxes:"**Gross Receipts Based Taxes:**

> This credit extends only to those taxes that are imposed on net income; the credit does **not** extend to taxes based on or derived directly from gross receipts. Gross receipts based taxes include: GRT, Washington Gross Receipts Tax; GMT, Texas Gross Margin Tax; CAT, Ohio Commercial Activity tax. Gross receipts-based taxes like the GRT, GMT and CAT are each taxes imposed for the privilege of doing business in a state. These taxes are **not** based on income and are due whether a business is profitable or not. Therefore, these taxes are not in the nature of net income taxes imposed on taxpayers, either directly or by imposition on pass-through entities in which the taxpayers are members.

http://www.mass.gov/dor/individuals/filing-and-payment-information/guide-to-personal-income-tax/credits/income-tax-paid-to-another-jurisdiction-credit.html#Scorp (last accessed November 9, 2013) (emphasis added).

out-of-state taxes paid may be incentivized to resist paying their fair share of taxes.[19] The Constitution cannot be construed to instigate a taxpayer revolt in every instance where one state does not afford a complete income tax credit for taxes paid in another jurisdiction.

The *amici* respectfully submit that these issues warrant the Court's review.

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[19] Within weeks after the Court of Appeals' decision, a major accounting firm began promoting in its web site that all Maryland residents (irrespective of any S-corporation affiliation) who paid any income taxes out-of-state in 2009 should file a "protective refund claim" for their 2009 Maryland income taxes and be prepared to file similar claims for subsequent years. www.dhgllp.com/res_pubs/Protective-Refund-Claims.pdf (last accessed November 11, 2013).

CONCLUSION

For the foregoing reasons, and those in the petition, the Court should issue a writ of certiorari and reverse the judgment below.

Respectfully submitted.

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November 18, 2013

JOINT APPENDIX

No. 13-485

In The Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,

Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

On Writ of Certiorari to the
Court of Appeals of Maryland

JOINT APPENDIX

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JULY 2014

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Petition for Writ of Certiorari filed October 13, 2013
Petition for Writ of Certiorari granted May 27, 2014

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Maryland Tax Court Agreed Statement of Facts and Stipulation of Exhibits (April 1, 2009) . . . . . JA 9

Exhibit A: Petitioners' 2006 Maryland Form 502 with attachments . . . . . JA 13

Exhibit B: Petitioner Brian Wynne's 2006 Schedule K-1 from Maxim Healthcare Services, Inc. . . . . JA 60

Exhibit C: Chart comparing the figures submitted by Petitioners on their 2006 Maryland Form 502 and the adjusted figures determined by the Comptroller . . . JA 75

Exhibit D: Chart summarizing Maxim Healthcare Services, Inc.'s state filings for 2006 and the Comptroller's calculation of the corresponding credit to which the Petitioners are entitled towards their 2006 Maryland income tax liability [Fold-Out Exhibit] . . . . . JA 77

Exhibit E: Notice of Final Determination . JA 78

Exhibit F: Petitioners' Petition of Appeal . JA 88

Exhibit G: Affidavit of Pamela L. Porter, Revenue Administrator, Office of the Comptroller . . . . . JA 94

Exhibit H: 2006 Maryland Form 502CR* . . JA 97

Exhibit I: Instructions to 2006 Maryland Form 502CR* . . . . . JA 106

Maryland Tax Court Amended Agreed Statement of Facts and Stipulation of Exhibits (May 28, 2009) . . . . . JA 121

*Source documents available in unaltered format at: http://forms.marylandtaxes.com/06_forms/502cr.pdf

The following opinions, decisions, judgments, and orders have been omitted in printing this joint appendix because they appear on the following pages in the appendix to the petition for a writ of certiorari:

Appendix A: Opinion and Dissenting Opinion in the Court of Appeals of Maryland (January 28, 2013) . . . . . App. 1

Appendix B: Opinion on Motion for Reconsideration in the Court of Appeals of Maryland (May 17, 2013) . . . . . App. 50

Appendix C: Memorandum and Order in the Circuit Court for Howard County (June 29, 2011) . . . . . App. 53

Appendix D: Continued Hearing Transcript in the Maryland Tax Court (December 10, 2009) . . . . . App. 130

Appendix E: Order in the Maryland Tax Court (December 29, 2009) . . . . . App. 140

Appendix F: Pertinent Statutes: Annotated Code of Maryland, Tax-General Article, §§ 10-102, 10-103, 10-703 . . . . App. 142

RELEVANT DOCKET ENTRIES

Maryland Tax Court

No. 08-IN-OO-0791

Brian and Karen Wynne v. Comptroller of the Treasury

Oct. 24, 2008	Petition of Appeal, with attachments, filed by Attys. for Petitioners
	* * *
Nov. 24	Answer filed by Atty. for Respondent
Apr. 13, 2009	Amended Petition of Appeal, with attachments, filed by Attys. for Petitioners
Apr. 16	Agreed Statement of Facts and Stipulation of Exhibits filed by Attys.
Apr. 17	Answer to Amended Petition of Appeal filed by Atty. for Respondent
Apr. 23	Partial Motion to Dismiss or, in the Alternative, Partial Motion for Summary Judgment filed by Atty. for Respondent
	* * *

May 8	Revised Amended Petition of Appeal, with attachment, filed by Attys. for Petitioners
May 8	Pre-Hearing Brief of Petitioners, with attachments, filed by Attys.
May 29	Comptroller's Pre-Trial Memorandum of Law, with attachment, filed by Atty.
May 29, 2009	Amended Agreed Statement of Facts and Stipulation of Exhibits filed by Attys.
Jul. 1	Transcript of Testimony for hearing held on 6/18/09
Jul. 16	Motion Requesting Grounds for Decision filed by Attys. for Petitioners
Jul. 16	Post-Hearing Brief of Petitioners filed by Attys.
Aug. 14	Comptroller's Post-Trial Reply Memorandum filed by Atty.
Oct. 29	Letter to Attys. dated 10/29/09 from Clerk of MTC – Judge Silberg's hypothetical
Dec. 3	Petitioners' Response to Hypothetical filed by Attys.
Dec. 29	Order signed – affirmed

Feb. 3, 2010	Copy of Petition for Judicial Review in the Circuit Court for Howard County filed by Atty. for Petitioners
	* * *
Mar. 12	Transcript of Testimony for hearing held on 12/10/09

RELEVANT DOCKET ENTRIES

Circuit Court for Howard County

Case No. 13-C-10-080987 AA

In the Matter of Brian Wynne, et al.

Num/Seq	Description	Filed
0001000	Petition for Judicial Review with attached exhibits Filed by PET001-Wynne, PET002-Wynne	01/25/10
0001001	Response to Petition for Judicial Review	02/17/10
0002000	Motion for Admission of Out-of-State Attorney Filed by PET001-Wynne, PET002- Wynne * * *	01/25/10
0003000	Notice to Administrative Agency Issued 02/05/10 signed copy ret'd	01/28/10
	* * *	
0006000	Transcript of Record from Administrative Agency	04/05/10
	* * *	
0009000	Opening Brief for Petitioners w/Exhibits Filed by PET002-Wynne, PET001-Wynne	05/06/10

0010000	Answering Memorandum of Law	06/04/10
	* * *	
0012000	Reply Memorandum of Law w/Exhibits	06/25/10
0013000	Open Court Proceeding Hearing on Administrative Agency Appeal Petition for judicial review * * *	07/07/10
0014000	Memorandum * * *	06/29/11
0015000	Order--judgment of tax court reversed; case remanded * * *	06/29/11
0016000	Notice of Appeal to COSA * * *	07/22/11
0017000	Transcript of Wednesday, July 7, 2010	09/09/11
0018000	Order - Appeal to Proceed (COSA)	09/15/11
0019000	Notice from COA--petition for writ of certiorari has been filed	11/04/11
0020000	Original Record sent to COSA * * *	11/10/11

RELEVANT DOCKET ENTRIES

Maryland Court of Appeals

No. 107 - 2011 T.

Maryland State Comptroller of the Treasury v. Brian Wynne, et ux.

* * *

March 12, 2012 –	Brief of Appellant received.
	* * *
April 13, 2012 –	Brief of Appellees received.
	* * *
	* * *
April 30, 2012 –	Reply Brief of Appellant received.
January 28, 2013 –	Judgment of the Circuit Court for Howard County affirmed with direction to remand to the Tax Court for further proceedings consistent with this opinion. costs to be shared equally by the parties. **Opinion by McDonald, J. Dissenting Opinion by Greene, J., which Battaglia, J., Joins.**

February 27, 2013:	Motion for Reconsideration and, alternatively, for stay of enforcement of the judgment filed by AG's Office. * * *
March 21, 2013 –	The Court is requesting that an answer to the motion for reconsideration be filed on behalf of the Appellees. The answer shall be due in our office on or before April 11, 2013.
April 10, 2013 –	Answer in Opposition to the Comptroller's Motion for Reconsideration or Stay filed.
April 18, 2013 –	Reply Memorandum in Support of Motion for Reconsideration and, Alternatively, for Stay of Enforcement of the Judgment filed.
April 22, 2013 –	Motionto Submit Supplemental Authority Relevant to the Comptroller's Motion for Reconsideration or Stay filed.
April 26, 2013 –	Response to Motion to Submit Supplemental Authority filed.

May 17, 2013 –	The Motion for Reconsideration is DENIED; however, we shall STAY the effective date of the mandate pending the disposition of a timely petition for certiorari filed by the Comptroller with the United States Supreme Court. **OPINION ON MOTION FOR RECONSIDERATION BY MCDONALD, J.**
August 2, 2013:	Correspondence filed from the U.S. Supreme Court.
May 30, 2014:	Notice of petition granted in the U.S. Supreme Court.
June 3, 2014:	Record sent to U.S. Supreme Court.

IN THE
MARYLAND TAX COURT

APPEAL NO.: 08-IN-OO-0791

[Dated April 1, 2009]

BRIAN AND KAREN WYNNE	)
	)
Petitioners	)
	)
v.	)
	)
COMPTROLLER OF THE TREASURY	)
	)
Respondent	)
	)

AGREED STATEMENT OF FACTS AND STIPULATION OF EXHIBITS

The parties hereby stipulate and agree for the purposes of this proceeding to the following matters. In so stipulating, the parties waive all objections to the admissibility of the stipulated facts and exhibits. The parties specifically stipulate and agree that the exhibits attached hereto are authentic and waive any objection to the admissibility of duplicates in lieu of originals of such exhibits.

1. The "Taxable Period" at issue in this matter is the calendar year 2006. Unless otherwise indicated, all provisions of the Agreed Statement of Facts and Stipulation of Exhibits ("Stipulation') apply to the Taxable Period.

2. Petitioners are married and residents of Maryland.

3. One of the Petitioners, Brian Wynne ("Wynne"), owns 2.4% of the stock in Maxim Healthcare Services, Inc. ("Maxim"), which has made an election under the Internal Revenue Code § 1362(a) to be treated as an S corporation.

4. In 2006, Maxim filed income tax returns in twenty-five (25) states. Maxim filed composite income tax returns in states which recognized pass-through taxation of S corporations and it filed corporate income tax returns in states which did not recognize such pass-through taxation of S corporations.

5. Maxim paid the state income tax due to each state for all composite returns and corporate returns. Maxim allocated a pro-rata share of taxes paid to other states with both the composite and corporate returns, to all its shareholders, including Wynne.

6. Wynne claimed $84,550.00 as his pro-rata share of such income taxes paid to other states as a credit on Petitioners' 2006 Maryland Form 502 pursuant to Tax-General § 10-703(c)(2).

7. The Comptroller of Maryland ("Comptroller"), consistent with its interpretation and application of Tax-General § 10-703(c) since its enactment, subsequently revised the credits for taxes paid to other states on Petitioners' 2006 Maryland Form 502 to the extent the credits claimed exceeded the amounts allowable under Tax-General § 10-703(c).

8. The Comptroller issued an assessment which Wynne appealed to the Hearings and Appeals Section of the Comptroller's Office. On October 6, 2008, the Hearings and Appeals Section issued a Notice of Final Determination affirming the assessment.

9. In addition to the above facts, the parties stipulate to the introduction of the following exhibits:

   A. Petitioners' 2006 Maryland Form 502 with attachments;

   B. Petitioner Brian Wynne's 2006 Schedule K-1 from Maxim Healthcare Services, Inc.;

   C. Chart comparing the figures submitted by Petitioners on their 2006 Maryland Form 502 and the adjusted figures determined by the Comptroller;

   D. Chart summarizing Maxim Healthcare Services, Inc.'s state filings for 2006 and the Comptroller's calculation of the corresponding credit to which the Petitioners are entitled towards their 2006 Maryland income tax liability;

   E. The Notice of Final Determination;

   F. Petitioners' Petition of Appeal;

   G. Affidavit of Pamela L. Porter, Revenue Administrator, Office of the Comptroller

   H. 2006 Maryland Form 502CR; and

   I. Instructions to 2006 Maryland Form 502CR.

Date: April 1, 2009

RESPONDENT

By its Attorney:

/s/Brian L. Oliner
Brian L. Oliner
Assistant Attorney General
80 Calvert Street, Room 303
P.O. Box 466
Annapolis, Maryland 21404-0466

PETITIONERS

/s/Brian Wynne
Brian Wynne

/s/Karen Wynne
Karen Wynne
15037 Bushy Park Road
Woodbine, MD 21797

/s/Robert A. Snyder, Jr.
Robert A. Snyder, Jr., Esq.
Matthew F. Penater, Esq.
Thomas & Libowitz, P.A.
100 Light Street, Suite 1100
Baltimore, Maryland 21202
Attorneys for Petitioners

EXHIBIT A

FORM 502 MARYLAND RESIDENT INCOME TAX RETURN 2006

OR FISCAL YEAR BEGINNING 2006, ENDING

SOCIAL SECURITY # [redacted]		SPOUSE'S SOCIAL SECURITY # [redacted]
Your First Name **BRIAN**	Initial **T**	Last Name **WYNNE**
Spouse's First Name **KAREN**	Initial **L**	Last Name **WYNNE**
PRESENT ADDRESS (No. and street) **15037 BUSHY PARK ROAD**		
City or Town **WOODBINE**	State **MD**	Zip Code **21797**
Name of county and incorporated city, town or special taxing area in which you were a resident on the last day of the taxable period. (See Instructions 6)	Maryland county **CR**	City, town or taxing area

YOUR FILING STATUS - See Instruction 1 to determine if you are required to file.

1. ☐ Single (if you can be claimed on another person's tax return, use Filing Status 6.)

2. ☒ Married filing joint return or spouse had no income

3. ☐ Married filing separately |_____|
SPOUSE'S SOCIAL SECURITY NUMBER

4. ☐ Head of household

5. ☐ Qualifying widow(er) with dependent child

6. ☐ Dependent taxpayer (Enter 0 in Exemption Box (A) - See Instruction 7)

PART-YEAR RESIDENT: If you began or ended legal residence in Maryland in 2006 place a P in the box (See instruction 26).

Give dates of Maryland Residence

MO DAY YR MO DAY YR

FROM _____ TO _____ ☐

Other state of residence _____

MILITARY: If you or your spouse has non-Maryland military income, place an M in the box. Enter amount here _____ (See Instruction 29).

EXEMPTIONS - See Instruction 10

(A) Yourself ☒ Spouse ☒

Check here if you are: (B) ☐ 65 or over ☐ Blind Spouse is: ☐ 65 or over ☐ Blind

Exemption Amount

Enter No. Checked (A) 2 x $2,400 $ 4800

Enter No. Checked (B) x $1,000 $ ____

Enter No. Checked in columns 4 & 5 (C) 5 x $2,400 $ 12000

Enter the Total Exemptions (Add A, B, and C) (D) 7 Total Amount $ 16800

(C) Dependents: (1) First name Last Name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) Regular	(5) 65 or Over
[redacted] WYNNE	[redacted]	CHILD	X	
[redacted] WYNNE	[redacted]	CHILD	X	
[redacted] WYNNE	[redacted]	CHILD	X	
[redacted] WYNNE	[redacted]	CHILD	X	
[redacted] WYNNE	[redacted]	CHILD	X	

Print your numbers like this - 0123456789 - not like this 047

INCOME

			Dollars
1. Adjusted gross income from your federal return (See Instruction 11)		1	2745816
1a. Wages, salaries and/or tips (See Instruction 11)	1a 1064808		
ADDITIONS TO INCOME (See Instruction 12)			
2. Tax-exempt interest on state and local obligations (bonds) other than Maryland		2	
3. State retirement pickup		3	
4. Lump sum distributions (from worksheet in instruction 12)		4	
5. Other additions (Enter code letter(s) from instruction 12) STMT 1	D	5	21790
6. Total additions to Maryland income (Add lines 2 through 5)		6	21790
7. Total federal adjusted gross income and Maryland additions (Add lines 1 and 6)		7	2767606

Place your CHECK or MONEY ORDER on top of your wage and tax statements and attach here with ONE staple.

SUBTRACTIONS FROM INCOME (See Instruction 13)

8. Taxable refunds, credits or offsets of state and local income taxes included in line 1 above	8	11898
9. Child and dependent care expenses	9	
10. Income from U.S. obligations	10	
11. Pension exclusion from worksheet in Instruction 13	11	
12. Taxable social security and RR benefits (Tier I, II and supplemental) included in line 1 above	12	
13. Income received during period of nonresidence (See Instructions 26 and 29)	13	
14. Other subtractions (Enter code letter(s) from Instruction 13) STMT 1 G	14	2732
15. Subtotal (Add lines 8 through 14)	15	14630
16. Two-income subtraction from worksheet in Instruction 13 SEE STATEMENT 2	16	1200

17. Total subtractions form Maryland income (Add lines 15 and 16) . . .		17	15830
18. Maryland adjusted gross income (Subtract line 17 from line 7)		18	2751776
DEDUCTION METHOD (All taxpayers must select one method and check the appropriate box)			
STANDARD DEDUCTION METHOD See Instruction 16 and worksheet. (Enter amount on line 19)			
ITEMIZED DEDUCTION METHOD Complete lines 19a and 19b		X	
Total federal itemized deductions (from line 28, federal Schedule A)	19a.	148937	
State and local income taxes included in federal Schedule A, line 5 (or from worksheet in Instruction 14)	19b.	81094	
Subtract line 19b from line 19a and enter amount on line 19.			
19. Deduction amount (Part-year residents see Instruction 28 (l and m) and military personnel see Instruction 29)		19	67843
20. Net income (Subtract line 19 from line 18)		20	2683933
21. Exemption amount from Exemptions area above (See instruction 10)		21	16800
22. Taxable net income (Subtract line 21 from line 20		22	2667133

MARYLAND TAX COMPUTATION		Dollars
23. Amount from line 22 (taxable net income) GO TO TAX TABLE, page 18. Enter the tax on line 24.	23	2667133
24. Maryland tax (from Tax Table or Computation Worksheet)	24	126636
25. Earned income credit (½ of federal earned income credit. See Instruction 18).	25	
26. Poverty level credit (See Instruction 18)	26	
27. Other income tax credits for individuals from Part G, line 8 of Form 502CR (Attach Form 502CR)	27	84550
28. Business tax credits (Attach Form 500CR)	28	
29. Total credits (Add lines 25 through 28)	29	84550
30. Maryland tax after credits (Subtract line 29 from line 24) If less than 0, enter 0	30	42086
LOCAL TAX COMPUTATION		
31. Local tax (See Instruction 19 for tax rates and worksheet.) Multiply line 23 by your local tax rate **.0305** or use the Local Tax Worksheet	31	81348
32. Local earned income credit (from Local Earned Income Credit Worksheet in Instruction 19)	32	

33.	Local poverty level credit (from Local Poverty Level Credit Worksheet in Instruction 19)	33	
34.	Total credits (Add lines 32 and 33)	34	
35.	Local tax after credits (Subtract line 34 from line 31) If less than 0, enter 0	35	**81348**
36.	Total Maryland and local tax (Add lines 30 and 35)	36	**123434**
37.	Contribution to Chesapeake Bay and Endangered Species Fund (See Instruction 20)	37	
38.	Contribution to Fair Campaign Financing Fund (See Instruction 20)	38	
39.	Contribution to Maryland Cancer Fund (See Instruction 20)	39	
40.	Total Maryland income tax, local income tax and contributions (Add lines 36 through 39)	40	**123434**
41.	Total Maryland and local tax withheld (Enter total from and attach your W-2 and 1099 forms if MD tax is withheld)	41	**82793**
42.	2006 estimated tax payments, amount applied from 2005 return and payment made with an extension request Form 502E	42	**25794**
43.	Refundable earned income credit (from worksheet in Instruction 21)	43	
44.	Refundable income tax credits from Part H, line 6 of Form 502CR (Attach Form 502CR. See Instruction 21)	44	

45. Total payments and credits (Add lines 41 through 44)		45	108587
46. Balance due (If line 40 is more than line 45, subtract line 45 from line 40)		46	14847
47. Overpayment (If line 40 is less than line 45, subtract line 40 from line 45)		47	
48. Amount of overpayment TO BE APPLIED TO 2007 ESTIMATED TAX	48		
49. Amount of overpayment TO BE REFUNDED TO YOU (Subtract line 48 from line 47) See line 52 REFUND		49	
50. Interest charges from FORM 502UP [ ] or for late filing [ ] (See Instruction 22) Total		50	
51. TOTAL AMOUNT DUE (Add lines 46 and 50) IF $1 OR MORE, PAY IN FULL WITH THIS RETURN		51	14847

For credit card payment check here ☐ and see Instruction 24. Direct debit is available only if you file electronically.

DIRECT DEPOSIT OR REFUND (See Instruction 22) Please be sure the account information is correct.

52. To choose the direct deposit option, complete the following information:
52a. Type of account: ☐ Checking ☐ Savings
52b. Routing number [ ] 52c. Account number [ ]

[redacted]	[redacted]			
Daytime telephone no.	Home telephone no.	CODE NUMBERS (3 digits per box)		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements and to the best of my knowledge and belief it is true, correct and complete. If prepared by a person other than taxpayer, the declaration is based on all information of which the preparer has any knowledge. Check here ☒ if you authorize your preparer to discuss this return with us.	Make checks payable to: COMPTROLLER OF MARYLAND. It is recommended that you include your social security number on check. Mail to: Comptroller of Maryland, Revenue Administration Division, Annapolis, Maryland 21411-0001

_____ _____ Your signature Date	**APR 11 2007** **[Redacted] -7275** Preparer's SSN or PTIN	**/s/Bryant K. Cangile, CPA** Signature of preparer other than taxpayer

Spouse's signature Date		**PRICEWATERHOUSECOOPERS LLP** **1800 TYSONS BOULEVARD** **MCLEAN VA 221024261** **4107837600** Address and telephone number of preparer

13-4008324

FORM 502CR

MARYLAND
INCOME TAX CREDITS FOR INDIVIDUALS
ATTACH TO YOUR TAX RETURN

2006

SOCIAL SECURITY # [redacted]		SPOUSE'S SOCIAL SECURITY # [redacted]
Your First Name **BRIAN**	Initial **T**	Last Name **WYNNE**
Spouse's First Name **KAREN**	Initial **L**	Last Name **WYNNE**

Read Instructions for Form 502CR	*Note: You must complete and submit both pages 1 and 2 of this form to receive credit for the items listed.*

PART A - TAX CREDITS FOR INCOME TAXES PAID TO OTHER STATES

If you were a part-year resident, you may not claim a credit for tax paid on nonresident income you subtracted on line 13 of Form 502.

1.	Enter your taxable net income from line 22, Form 502	1	**2667133**

JA 24

2. Taxable net income in other state. Write on this line only the net income which is taxable in both the other state and Maryland. If you are taxed in the other state on income which is not taxable in Maryland, do not include that amount here	2	22394
NOTE: When the tax in the other state is a percentage of a tax based on your total income regardless of source, you must apply the same percentage to your taxable income in the other state to determine the income taxable in both states.		
3. Revised taxable net income (Subtract line 2 from line 1.) If less than zero, enter zero.	3	2644739
4. Enter the Maryland tax from line 24, Form 502. This is the Maryland tax based on your total income for the year.	4	126636
5. Tax on amount on line 3. Compute the Maryland tax that would be due on the revised taxable net income by using the Maryland Tax Table or Computation Worksheet contained in the instructions for Form 502. Do not include the local income tax.	5	125573
6. Tentative tax credit (Subtract line 5 from line 4.) If less than zero, enter zero.	6	1063

7. State tax shown on the tax return filed with the state of **AZ** Enter 2-letter state code 2-letter state code must be entered for credit to be allowed. Enter the amount of your 2006 income tax liability (after deducting any credits for personal exemptions) to a state other than Maryland. Do not enter state tax withheld from your W-2 forms. It is important that a copy of the tax return that was filed with the other state be attached to your Maryland return.	7	**618**
8. Credit for income tax paid to other state. Your credit for taxes paid to another state is the smaller of the tax actually paid (line 7) or the reduction in Maryland tax resulting from the exclusion of income in the other state (line 6). Write the smaller of line 6 or line 7 here and on line 1, Part G, page 2	8	**618**

PART B - CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

1. Enter your federal adjusted gross income from line 1 of Form 502 or line 17, column 1 of Form 505 or Form 515	1	
2. Enter your federal Child and Dependent Care Credit from federal Form 2441 or 1040A, Schedule 2	2	
3. Enter the decimal amount from the chart in the instructions that applies to the amount on line 1	3	

4. Multiply line 2 by line 3. Enter here and on line 2, Part G, page 2	4	

PART C - QUALITY TEACHER INCENTIVE CREDIT

		Taxpayer A		Taxpayer B	
1. Enter the Maryland public school system in which you teach		Name of Public School System - Maryland		Name of Public School System - Maryland	
2. Enter amount of tuition paid to: Name of Institution	2		2		
3. Enter amount of tuition reimbursement	3		3		
4. Subtract line 3 from line 2	4		4		
5. Maximum credit	5	1500	5	1500	
6. Enter the lesser of line 4 or line 5 here	6		6		
7. Total (Add amounts from line 6, for Taxpayers A and B.) Enter here and on line 3, Part G, page 2	7				

ARIZONA FORM 140NR

Nonresident Personal Income Tax Return
FOR CALENDAR YEAR 2006 OR
FISCAL YEAR BEGINNING AND ENDING

2006

66

1	YOUR FIRST NAME AND INITIAL **BRIAN T**	LAST NAME **WYNNE**	YOUR SOCIAL SECURITY NO. [redacted]
1	IF A JOINT RETURN, SPOUSE'S FIRST NAME AND INITIAL **KAREN L**	LAST NAME **WYNNE**	SPOUSE'S SOCIAL SECURITY NO. [redacted]
2	PRESENT HOME ADDRESS -NUMBER AND STREET, RURAL ROUTE APT. NO. **15037 BUSHY PARK ROAD**	DAYTIME PHONE (with area code) [redacted]	89 ☒
3	CITY, TOWN OR POST OFFICE STATE ZIP CODE **WOODBINE MD 21797**	HOME PHONE (with area code) 94[redacted]	*Check this box if:* 82F ☐ Filing under extension

JA 28

Filing Status	4	X	Married filing joint return	FOR DOR USE ONLY	
	5		Head of household - *name of qualifying child or dependent*		
	6		Married filing separate return. *Enter spouse's Social Security Number above and full name here*		
	7		Single		
			Enter the number claimed. Do not put a check mark.	88	
Exemptions	8		Age 65 or over (you and/or spouse)		
	9		Blind (you and/or spouse)		
	10	5	Dependents. *From page 2, line A2 - Do not include self or spouse.*	81	80
	11-13	Residency Status (*check one*): 11 ☒ Nonresident 12 ☐ Nonresident Active Military 13 ☐ Composite Return			

ATTACH PAYMENT HERE. Attach W-2 to back of last page of the return. If itemizing, attach your federal Sch. A and Arizona Sch. A.

THIS BOX MAY BE BLANK OR MAY CONTAIN A PRINTED BARCODE OF DATE FROM YOUR RETURN

14	Federal AGI	14	**2,745,816**	00		
15	Arizona income *(from page 2, line B15)*				15	**31,089** 00
16	Additions to income *(from page 2, line C20)*				16	00
17	*Add lines 15 and 16*				17	**31,089** 00
18	Subtractions. *Number from line D29a:* 18[1] ☐				18	**130** 00
19	Arizona AGI. *Line 17 minus line 18*				19	**30,959** 00
20	20[I] ☐ ITEMIZED 20[S] ☒ STANDARD				20	**8,494** 00
21	Personal exemptions.				21	**71** 00
22	AZ taxable inc. *Line 19 minus lines 20 & 21*				22	**22,394** 00
23	Compute tax. *Use Tax Rate Table X or Y*				23	**618** 00

24	Tax from recapture of credits	24		00
25	Subtotal of tax. *Add lines 23 and 24*	25	**618**	00
26 - 27	Clean Elections Fund Tax Reduction			
	26[1] ☐ YOURSELF 26[2] ☐ SPOUSE	27		00
28	Reduced tax. *Subtract line 27 from line 25*	28	**618**	00
29	Credits from Arizona Form 301, line 57, or Forms 321, 322 and 323 if Form 301 is not required	29		00
30	Credit type. *Enter form number of each credit claimed:* 30 ____ ____ ____ ____			
31	Clean Elections Fund Tax Credit. *From worksheet on page 15 of the instructions*	31		00
32	Balance of tax. *Subtract lines 29 and 31 from line 28. If the sum of lines 29 and 31 is more than line 28, enter zero*	32	**618**	00
33	Arizona income tax withheld during 2006	33		00
34	Arizona estimated tax payments for 2006	34	**704**	00

35	Amount paid with 2006 Arizona extension request (Form 204)	35		00
36	Total payments/refundable credits. *Add lines 33 through 35*	36	**704**	00
37	TAX DUE. *If line 32 is larger than line 36, subtract line 36 from line 32, and enter amount of tax due. Skip lines 38, 39 and 40*	37		00
38	OVERPAYMENT. *If line 36 is larger than line 32, subtract line 32 from line 36, and enter amount of overpayment*	38	**86**	00
39	Amount of line 38 to be applied to 2007 estimated tax	39	**86**	00
40	Balance of overpayment. *Subtract line 39 from line 38*	40		00
41-	49 Voluntary Gifts to:			

AID TO EDUCATION *(entire refund only)*	41		00	ARIZONA WILDLIFE	42		00	CITIZENS CLEAN ELECTIONS	43		00
CHILD ABUSE PREVENTION	44		00	DOMESTIC VIOLENCE SHELTER	45		00	NATIONAL GUARD RELIEF FUND	46		00

NEIGHBORS HELPING NEIGHBORS | 47 | 00

SPECIAL OLYMPICS | 48 | 00

POLITICAL GIFT | 49 | 00

50 *Check only one* if making a political gift: 50[1] ☐ Democratic 50[2] ☐ Libertarian 50[3] ☐ Republican

51 Estimated payment penalty and MSA withdrawal penalty . . . . . | 51 | 00

52 *Check applicable boxes:* 52[1] ☐ Annualized/Other 52[2] ☐ Farmer or Fisherman 52[3] ☐ Form 221 attached 52[4] ☐ MSA Penalty

53 Total of lines 41, 42, 43, 44, 45, 46, 47, 48, 49 and 51 . . . . . | 53 | 00

54 REFUND. *Subtract line 53 from line 40. If less than zero, enter amount owed on line 55* . . . . . | 54 | 00

Direct Deposit of Refund: See instructions

ROUTING NUMBER ACCOUNT NUMBER

98

C ☐ Checking or

S ☐ Savings

55 AMOUNT OWED. *Add lines 37 and 53.* Make check payable to Arizona Department of Revenue; Include SSN on payment. ☐ Payment enclosed. *Check the box and attach payment.*	55		00

PART A: Dependents - do not list yourself or spouse

A1 List children and other dependents. If more space is needed, attach a separate sheet.

FIRST AND LAST NAME	SOCIAL SECURITY NO.	RELATIONSHIP	NO. OF MONTHS LIVED IN YOUR HOME IN 2006
SEE STATEMENT 1			

A2 Enter total number of persons listed in A1 here and on the front of this form, box 10 ..... TOTAL | A2 | 5

A3 a Enter the names of the dependents listed above who do not qualify as your dependent on your federal return:

_____ _____ _____

b Enter dependents listed above who were not claimed on your federal return due to education credits:

_____ _____ _____

PART B: Arizona Percent of Total Income

		2006 FEDERAL Amount from federal return		2006 ARIZONA Source amount only	
B4	Wages, salaries, tips, etc.	**1,064,808**	00		00
B5	Interest	**42,861**	00		00
B6	Dividends	**13,073**	00		00
B7	Arizona income tax refunds	**11,898**	00		00
B8	Business income (or loss) from federal Schedule C		00		00
B9	Gains (or losses) from federal Schedule D	**-10,431**	00		00
B10	Rents, royalties, partnerships, estates, trusts, small business corporations from federal Schedule E	**1,623,607**	00	**31,089**	00
B11	Other income reported on your federal return		00		00
B12	Total income: *Add lines B4 through B11*	**2,745,816**	00	**31,089**	00
B13	Other federal adjustments. *Attach your own schedule*		00		00
B14	Federal adjusted gross income. *Subtract line B13 from line B12 in the FEDERAL column*	**2,745,816**	00		

B15 Arizona income: *Subtract line B13 from line B12 in the ARIZONA column. Enter here and on the front of this form on line 15*	B15	**31,089**	00
B16 Arizona percentage: *Divide line B15 by line B14, and enter the result (not over 100%)*	B16		**1.13%**

PART C: Additions to Income

C17 Early withdrawal of Arizona Retirement System contributions	C17		00
C18 Total depreciation included in Arizona gross income	C18		00
C19 Other additions to income. *See instructions and attach your own schedule*	C19		00
C20 Total: *Add lines C17 through C19. Enter here and on the front of this form on line 16*	C20		00

PART D: Subtractions from Income

D21 Exemption: Age 65 or over. *Multiply the number in box 8, page 1, by $2,100*	D21		00
D22 Exemption: Blind. *Multiply the number in box 9, page 1, by $1,500*	D22		00
D23 Exemption: Dependents. *Multiply the number in box 10, page 1, by $2,300*	D23	**11,500**	00

D24	Total exemptions: *Add lines D21 through D23*	D24	11,500	00	
D25	*Multiply line D24 by the percentage on line B16, and enter the result*	D25	130	00	
D26	Interest on U.S. obligations such as U.S. savings bonds and treasury bills included in the ARIZONA column	D26		00	
D27	Arizona state lottery winnings included on line B11 in the ARIZONA column (up to $5,000 only)	D27		00	
D28	Agricultural crops contributed to Arizona charitable organizations	D28		00	
D29	Construction of an energy efficient residence. *See page 10 of the Instructions. Enter number* D29a □, *then amount*	D29		00	
D30	Other subtractions from income. *See instructions and attach your own schedule*	D30		00	
D31	Total: *Add lines D25 through D30. Enter here and on the front of this form, line 18*	D31	130	00	

Part E: Last Name(s) Used in Prior Years if different from name(s) used in current year

E32

PLEASE SIGN HERE

I have read this return and any attachments with it. Under penalties of perjury, I declare that to the best of my knowledge and belief, they are true, correct and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

YOUR SIGNATURE	DATE	OCCUPATION
SPOUSE'S SIGNATURE	DATE	SPOUSE'S OCCUPATION
		PRICEWATERHOUSECOOPERS, LLP
PAID PREPARER'S SIGNATURE		FIRM'S NAME (PREPARER'S IF SELF-EMPLOYED)
		1800 TYSONS BOULEVARD MCLEAN, VA 22102-4261
PAID PREPARER'S TIN	DATE	PAID PREPARER'S ADDRESS

If you are sending a payment with this return, mail to Arizona Department of Revenue, PO Box 52016, Phoenix, AZ, 85072-2016.
If you are expecting a refund or owe no tax, or owe tax but are not sending payment, mail to Arizona Department of Revenue, PO Box 52138, Phoenix, AZ, 85072-2138.

FORM 502CR

MARYLAND
INCOME TAX CREDITS FOR INDIVIDUALS
ATTACH TO YOUR TAX RETURN

2006

SOCIAL SECURITY # [redacted]		SPOUSE'S SOCIAL SECURITY # [redacted]
Your First Name **BRIAN**	Initial **T**	Last Name **WYNNE**
Spouse's First Name **KAREN**	Initial **L**	Last Name **WYNNE**

Read Instructions for Form 502CR	*Note: You must complete and submit both pages 1 and 2 of this form to receive credit for the items listed.*

PART A - TAX CREDITS FOR INCOME TAXES PAID TO OTHER STATES

If you were a part-year resident, you may not claim a credit for tax paid on nonresident income you subtracted on line 13 of Form 502.

1. Enter your taxable net income from line 22, Form 502 ..... | 1 |

JA 40

2.	Taxable net income in other state. Write on this line only the net income which is taxable in both the other state and Maryland. If you are taxed in the other state on income which is not taxable in Maryland, do not include that amount here	2	878589
	NOTE: When the tax in the other state is a percentage of a tax based on your total income regardless of source, you must apply the same percentage to your taxable income in the other state to determine the income taxable in both states.		
3.	Revised taxable net income (Subtract line 2 from line 1.) If less than zero, enter zero.	3	
4.	Enter the Maryland tax from line 24, Form 502. This is the Maryland tax based on your total income for the year.	4	
5.	Tax on amount on line 3. Compute the Maryland tax that would be due on the revised taxable net income by using the Maryland Tax Table or Computation Worksheet contained in the instructions for Form 502. Do not include the local income tax.	5	
6.	Tentative tax credit (Subtract line 5 from line 4.) If less than zero, enter zero.	6	

7.	State tax shown on the tax return filed with the state of Enter 2-letter state code 2-letter state code must be entered for credit to be allowed. Enter the amount of your 2006 income tax liability (after deducting any credits for personal exemptions) to a state other than Maryland. Do not enter state tax withheld from your W-2 forms. It is important that a copy of the tax return that was filed with the other state be attached to your Maryland return.	7	21790
8.	Credit for income tax paid to other state. Your credit for taxes paid to another state is the smaller of the tax actually paid (line 7) or the reduction in Maryland tax resulting from the exclusion of income in the other state (line 6). Write the smaller of line 6 or line 7 here and on line 1, Part G, page 2	8	21790

PART B - CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

1.	Enter your federal adjusted gross income from line 1 of Form 502 or line 17, column 1 of Form 505 or Form 515	1	
2.	Enter your federal Child and Dependent Care Credit from federal Form 2441 or 1040A, Schedule 2	2	
3.	Enter the decimal amount from the chart in the instructions that applies to the amount on line 1	3	

4. Multiply line 2 by line 3. Enter here and on line 2, Part G, page 2	4	

PART C - QUALITY TEACHER INCENTIVE CREDIT

		Taxpayer A		Taxpayer B	
1. Enter the Maryland public school system in which you teach		Name of Public School System - Maryland		Name of Public School System - Maryland	
2. Enter amount of tuition paid to: Name of Institution	2		2		
3. Enter amount of tuition reimbursement	3		3		
4. Subtract line 3 from line 2	4		4		
5. Maximum credit	5	1500.00	5	1500.00	
6. Enter the lesser of line 4 or line 5 here	6		6		

7. Total (Add amounts from line 6, for Taxpayers A and B.) Enter here and on line 3, Part G, page 2	7	

Brian T. Wynne
Entity Tax
FYE 12/31/2006

Tax Iden. #: [redacted]

The following entitles are Maryland S corporations or C corporations that filed corporate tax returns and paid taxes in the following states for the calendar year ended 12/31/2006:

S Corporation	Taxable Income	Tax Due
California	244,584	3,669
Illinois	54,593	819
Kentucky	6,551	399
Massachusetts	25,548	1,288
Michigan	188,629	3,226
Mississippi	1,045	52
Pennsylvania	200,640	981
South Carolina	None	None
Tennessee	36,848	2,395
Wisconsin	9,695	19
C Corporation		
Arkansas	3,120	177
DC	4,017	401
Louisiana	5,953	386
New Jersey	45,037	4,053
New York	52,332	3,925
SUBTOTAL	878,689	21,790
TOTAL	878,689	21,790

FORM 502CR

MARYLAND
INCOME TAX CREDITS FOR INDIVIDUALS
ATTACH TO YOUR TAX RETURN

2006

SOCIAL SECURITY # [redacted]		SPOUSE'S SOCIAL SECURITY # [redacted]
Your First Name **BRIAN**	Initial **T**	Last Name **WYNNE**
Spouse's First Name **KAREN**	Initial **L**	Last Name **WYNNE**

Read Instructions for Form 502CR

Note: You must complete and submit both pages 1 and 2 of this form to receive credit for the items listed.

PART A - TAX CREDITS FOR INCOME TAXES PAID TO OTHER STATES

If you were a part-year resident, you may not claim a credit for tax paid on nonresident income you subtracted on line 13 of Form 502.

1. Enter your taxable net income from line 22, Form 502 1

JA 45

2. Taxable net income in other state. Write on this line only the net income which is taxable in both the other state and Maryland. If you are taxed in the other state on income which is not taxable in Maryland, do not include that amount here	2	1041507
NOTE: When the tax in the other state is a percentage of a tax based on your total income regardless of source, you must apply the same percentage to your taxable income in the other state to determine the income taxable in both states.		
3. Revised taxable net income (Subtract line 2 from line 1.) If less than zero, enter zero.	3	
4. Enter the Maryland tax from line 24, Form 502. This is the Maryland tax based on your total income for the year.	4	
5. Tax on amount on line 3. Compute the Maryland tax that would be due on the revised taxable net income by using the Maryland Tax Table or Computation Worksheet contained in the instructions for Form 502. Do not include the local income tax.	5	
6. Tentative tax credit (Subtract line 5 from line 4.) If less than zero, enter zero.	6	

7.	State tax shown on the tax return filed with the state of | | Enter 2-letter state code 2-letter state code must be entered for credit to be allowed. Enter the amount of your 2006 income tax liability (after deducting any credits for personal exemptions) to a state other than Maryland. Do not enter state tax withheld from your W-2 forms. It is important that a copy of the tax return that was filed with the other state be attached to your Maryland return.	7	62142
8.	Credit for income tax paid to other state. Your credit for taxes paid to another state is the smaller of the tax actually paid (line 7) or the reduction in Maryland tax resulting from the exclusion of income in the other state (line 6). Write the smaller of line 6 or line 7 here and on line 1, Part G, page 2	8	62142

PART B - CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

1.	Enter your federal adjusted gross income from line 1 of Form 502 or line 17, column 1 of Form 505 or Form 515	1	
2.	Enter your federal Child and Dependent Care Credit from federal Form 2441 or 1040A, Schedule 2	2	
3.	Enter the decimal amount from the chart in the instructions that applies to the amount on line 1	3	

4. Multiply line 2 by line 3. Enter here and on line 2, Part G, page 2	4	

PART C - QUALITY TEACHER INCENTIVE CREDIT

		Taxpayer A		Taxpayer B	
1. Enter the Maryland public school system in which you teach		Name of Public School System - Maryland		Name of Public School System - Maryland	
2. Enter amount of tuition paid to: Name of Institution	2		2		
3. Enter amount of tuition reimbursement	3		3		
4. Subtract line 3 from line 2	4		4		
5. Maximum credit	5	1500.00	5	1500.00	
6. Enter the lesser of line 4 or line 5 here	6		6		
7. Total (Add amounts from line 6, for Taxpayers A and B.) Enter here and on line 3, Part G, page 2	7				

Brian T. Wynne
Maxim Healthcare Services
S Corporation Composites
FYE 12/31/2006

Tax Iden. #: [redacted]

Maxim Healthcare Services, a Maryland S Corporation, employer I.D. Number [redacted], filed a composite tax return on behalf of its shareholders in the following states for the calendar year ended 12/31/06

	Taxable Income	Tax Due
Alabama	$ 13,474	$ 674
California	245,032	22,788
Colorado	57,622	2,668
Connecticut	34,264	1,713
Delaware	11,361	676
Georgia	33,873	2,032
Idaho	646	49
Illinois	54,593	1,638
Indiana	12,867	437
Iowa	1,263	113
Kansas	3,212	206
Maine	3,182	271
Massachusetts	25,541	1,354
Michigan	20,277	791
Minnesota	7,392	580
Mississippi	1,045	52
Missouri	20,926	1,256
Montana	111,119	11
Nebraska	3,720	254

New Mexico	12,024	637
North Carolina	128,702	9,441
Ohio	102,503	7,042
Oklahoma	11,167	670
Oregon	12,882	1,159
Pennsylvania	48,799	1,498
Rhode Island	5,434	435
South Carolina	12,086	846
Utah	5,477	382
Vermont	150	13
Virginia	29,398	1,684
West Virginia	1,783	116
Wisconsin	9,695	654
TOTAL	$ 1,041,507	$ 62,142

FORM 502CR 2006 MARYLAND INCOME TAX CREDITS FOR INDIVIDUALS

NAME **BRIAN T WYNNE** SSN [redacted]

PART D - CREDIT FOR AQUACULTURE OYSTER FLOATS

1. Enter the amount paid to purchase an aquaculture oyster float(s) Enter here and on line 4 of Part G below	1	

PART E - LONG-TERM CARE INSURANCE CREDIT: (this is a ONE-TIME credit)

Answer the questions and see instructions below before completing Columns A through E for each person for whom you paid long-term care insurance premiums.

Question 1 - Did the insured individual have long-term care insurance prior to July 1, 2000? ..... Yes ☐ No ☐

Question 2 - Is the credit being claimed for the insured individual in this year by any other taxpayer? ..... Yes ☐ No ☐

Question 3 - Has credit been claimed for the insured individual in any other tax year? ..... Yes ☐ No ☐

If you answered YES to any of the above questions, that insured person does NOT qualify for the credit.

Complete Columns A through D only for insured individuals who qualify for credit. Enter in Column E the lesser of the amount of premium paid for each insured person or:

$280 for those insured that are 40 or less, as of 12/31/06

$500 for those insured that are over age 40, as of 12/31/06.

Add the amounts in Column E and enter the total on line 5 (TOTAL) and Part G, line 5.

Column A Name of Qualifying Insured Individual	Age	Column B Social Security No. Of Insured	Column C Relationship to Taxpayer	Column D Amount of Premium Paid	Column E Credit Amount
1.					1.
2.					2.
3.					3.
4.					4.
5. TOTAL					5.

PART F - CREDIT FOR PRESERVATION AND CONSERVATION EASEMENTS

1.	Enter the total of the current year donation amount, and any carryover from prior year(s)	1	
2.	Enter the amount of any payment received for the easement during 2006	2	
3.	Subtract line 2 from line 1	3	
4.	Enter the amount from line 24 of Form 502, line 32c of Form 505 or line 33 of Form 515, or $5,000, whichever is less	4	
5.	Enter the lesser of lines 3 or 4 here and on line 6 of Part G below. (If you itemize deductions, see Instruction 14.)	5	
6.	Excess credit carryover. Subtract line 5 from line 3.	6	

PART G - INCOME TAX CREDIT SUMMARY

1.	Enter the amount form Part A, line 8 (If more than one state, see instructions)	1	84550
2.	Enter the amount form Part B, line 4	2	
3.	Enter the amount form Part C, line 7	3	
4.	Enter the amount form Part D, line 1	4	

5.	Enter the amount form Part E, line 5	5	
6.	Enter the amount from Part F, line 5	6	
7.	Enter the amount form Section 2, line 4 of Form 502H, Attach Form 502H.	7	
8.	Total (Add lines 1 through 7.) Enter this amount on line 27 of Form 502, line 35 of Form 505 or line 36 of Form 515	8	**84550**

PART H - REFUNDABLE INCOME TAX CREDITS

1.	Neighborhood Stabilization Credit. Enter the amount and attach certification.	1	
2.	Heritage Structure Rehabilitation Tax Credit (See instructions for Form 502H.) Attach certification.	2	
3.	Refundable Business Income Tax Credit (See instructions for Form 500CR.) Attach 500 CR	3	
4.	IRC Section 1341 Repayment Credit. (See Instructions) Attach documentation	4	

5.	Form 1041 Schedule K-1 Nonresident PTE tax (See instructions for required attachments)	5	
6.	Total (Add lines 1 through 5.) Enter this amount on line 44 of Form 502, line 47 of Form 505, or line 54 of Form 515	6	

BRIAN T WYNNE & KAREN L WYNNE [redacted]

ADJUSTMENTS TO INCOME
SUPPLEMENT TO MARYLAND

OTHER ADDITIONS TO INCOME

S CORPORATION TAXES	21,790.
TOTAL	21,790.

OTHER SUBTRACTIONS FROM INCOME

MAXIM HEALTHCARE WAGES IN WORK OPPORTUNITY CREDIT	2,732.
TOTAL	2,732.

STATEMENT 1

BRIAN T WYNNE & KAREN L WYNNE [redacted]

ADJUSTMENTS TO INCOME
SUPPLEMENT TO MARYLAND

TWO-INCOME MARRIED COUPLE SUBTRACTION WORKSHEET	TAXPAYER	SPOUSE
1. FEDERAL AGI ATTRIBUTABLE TO EACH SPOUSE	2,729,114.	16,702.
2. ADDITIONS ATTRIBUTABLE TO EACH SPOUSE	21,790.	
3. TOTAL OF LINES 1 AND 2	2,750,904.	16,702.
4. SUBTRACTIONS ATTRIBUTABLE TO EACH SPOUSE	8,681.	5,949.
5. LINE 3 LESS LINE 4	2,742,223.	10,753.
6. LESSER OF LINE 5-TAXPAYER AND SPOUSE AMOUNTS		10,753.
7. LESSER OF $1,200 OR LINE 6		1,200.

SEE THE FOLLOWING DETAIL FOR LINES 1, 2 AND 4

STATEMENT 2

BRIAN T WYNNE & KAREN L WYNNE [redacted]

ADJUSTMENTS TO INCOME
SUPPLEMENT TO MARYLAND

FEDERAL AGI ATTRIBUTABLE TO EACH SPOUSE	TAXPAYER	SPOUSE
WAGES, SALARIES, TIPS, ETC.	1,064,808.	
TAXABLE INTEREST INCOME	39,531.	3,330.
DIVIDEND INCOME	6,537.	6,536.
REFUNDS OF STATE/LOCAL INCOME TAXES	5,949.	5,949.
CAPITAL GAIN/LOSS	888.	887.
OTHER GAINS/LOSSES	-12,206.	
RENTS, ROYALTIES, PARTNERSHIPS, ETC.	1,623,607.	
FEDERAL ADJUSTED GROSS INCOME	2,729,114.	16,702.

ADDITIONS ATTRIBUTABLE TO EACH SPOUSE	TAXPAYER	SPOUSE
S CORPORATION TAXES	21,790.	
TOTAL ADDITIONS	21,790.	

SUBTRACTIONS ATTRIBUTABLE TO EACH SPOUSE	TAXPAYER	SPOUSE
REFUNDS OF STATE AND LOCAL INCOME TAXES	5,949.	5,949.
MAXIM HEALTHCARE WAGES IN WORK OPPORTUNITY CREDIT	2,732.	
TOTAL SUBTRACTIONS	8,681.	5,949.

STATEMENT 3

EXHIBIT B

671106

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0130

Schedule K-1 (Form 1120S) 2006

Department of the Treasury
Internal Revenue Service

For calendar year 2006, or tax year beginning _____
and ending _____

Shareholder's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Corporation	
A	Corporation's employer identification number [redacted]
B	Corporation's name, address, city, state, and ZIP code **MAXIM HEALTHCARE SERVICES, INC** **7227 LEE DE FOREST DRIVE** **COLUMBIA, MD 21046-3236**
C	IRS Center where corporation filed return **EFILE**
D	☐ Tax shelter registration number, if any _____
E	☐ Check if Form 8271 is attached

Part II Information About the Shareholder	
F	Shareholder's identifying number [redacted]
G	Shareholder's name, address, city, state, and ZIP code **BRIAN T. WYNNE** **15037 BUSHY PARK ROAD** **WOODBINE, MD 21797**
H	Shareholder's percentage of stock ownership for tax year . . . . . **2.400000** %

For IRS Use Only

Part III	Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items		
1	Ordinary business income (loss) **1,623,607.**	13 H	Credits WORK OPPORTUNITY **2,732.**
2	Net rental real estate income (loss)	I	WELFARE TO WORK **1,639.**
3	Other net rental income (loss)	K	EMPOWERMENT ZONE **4,766.**
4 *	Interest income **14,396.**		
5a	Ordinary dividends		
5b	Qualified dividends	14	Foreign transactions
6	Royalties		
7	Net short-term capital gain (loss)		
8a	Net long-term capital gain (loss)		
8b	Collectibles (28%) gain (loss)		

8c	Unrecaptured section 1250 gain		
9	Net section 1231 gain (loss) **-12,206.**		
10	Other income (loss)	15 A	Alternative minimum tax (AMT) items **-17,782.**
		B	**-1,591.**
11	Section 179 deduction	16 C*	Items affecting shareholder basis **23,125.**
12 A*	Other deductions **2,955.**	D	**610,627.**
		17 A	Other information **14,396.**
* See attached statement for additional information.			

For Privacy Act and Paperwork Reduction Act Notice, see Instructions for Form 1120S.

Schedule K-1 (Form 1120S) 2006

MAXIM HEALTHCARE SERVICES, INC [redacted]

FORM 1120S, SCHEDULE K-1, S/H #7 BRIAN T. WYNNE

SCH K-1, LINE 4 - INTEREST INCOME	
SCH K: OTHER INTEREST INCOME	14,385.
SCH K: CAREMAX MEDICAL RESOURCES	11.
TOTAL	14,396.
SCH K-1, LINE 12 - OTHER DEDUCTIONS	
CODE A - CASH CONTRIBUTIONS (50%)	
CHARITABLE	2,851.
50% CASH CONTRIBUTIONS FROM PASS-THROUGH ACTIVITIES	104.
TOTAL	2,955.

SCH K-1, LINE 16 - ITEMS AFFECTING SHAREHOLDER BASIS

CODE C - NONDEDUCTIBLE EXPENSES	
MEALS AND ENTERTAINMENT	11,871.
FLOW THRU FROM CAREMAX - MEALS AND ENTERTAINMENT	1,458.
FINES AND PENALTIES	655.
FLOW THRU FROM CAREMAX - PENALTIES	4.
EMPLOYMENT CREDIT	4,371.
EMPOWERMENT ZONE CREDIT	4,766.
TOTAL	23,125.

STATEMENT 1

MAXIM HEALTHCARE SERVICES, INC [redacted]

FORM 1120S, SCHEDULE K-1, S/H #7 BRIAN T. WYNNE

ORDINARY INCOME ACTIVITY

CAREMAX MEDICAL RESOURCES, LLC
7080 SAMUEL MORSE DRIVE
COLUMBIA, MD 21046
[redacted]

CHARITABLE CONTRIBUTIONS - CASH (50%)	104.

STATEMENT 2

MAXIM HEALTHCARE SERVICES, INC [redacted]

Shareholder Basis Schedule
For calendar year 2006 or tax year beginning and ending

Shareholder Number: 7
Shareholder Name: **BRIAN T. WYNNE**

	Stock Basis	Loan Basis	Suspended Loss
Beginning balances	1,316,172.		
Increases			
Separately computed items:			
Tax-exempt income			
Net income from rental real estate activities			
Net income from other rental activities			
Net portfolio income	14,396.		
Net section 1231 gain			
Other income			
Nonseparately computed income	1,623,607.		
New Loans to corporation			

Other increases			
Total increases	1,638,003.		
Decreases			
Distributions not included on Form 1099-DIV	610,627.		
Separately computed items:			
Net loss from rental real estate activities			
Net loss from other rental activities			
Net portfolio loss			
Net section 1231 loss	12,206.		
Other loss			
Charitable contributions	2,955.		
Section 179 expense deduction			
Deductions related to portfolio income (loss)			
Other deductions			
Interest expense on investment debts			

Foreign taxes			
Section 59(e)(2) expenditures			
Nonseparately computed loss			
Nondeductible expenses	23,125.		
Oil and gas depletion not exceeding basis			
Loans repaid by corporation			
Other decreases			
Total decreases	648,913.		
Application of net increase/decrease	989,090.		
Ending balances	2,305,262.		

SH # 7

ARIZONA K-1 Equivalent

For the calendar year 2006 or tax year

beginning **01/01/2006**, and ending **12/31/2006**

2006

Shareholder's identifying number [redacted]	Corporation's identifying number [redacted]
Shareholder's name, address, and ZIP code **BRIAN T. WYNNE** **15037 BUSHY PARK ROAD** **WOODBINE, MD 21797**	Corporation's name, address, and ZIP code **MAXIM HEALTHCARE SERVICES, INC** **7227 LEE DE FOREST DRIVE** **COLUMBIA, MD 21046-3236**

A Shareholder's percentage of stock ownership for tax year . . . . . **2.400000 %**

B Apportionment factor **1.912200**

C Resident . . . . ____ Non-Resident . . . . . **X**

(a) Pro rata share items		(b) Amount	Non Resident Apportionment
1 Ordinary business income (loss)	1	**1,623,607.**	**31,047.**
2 Net rental real estate income (loss) *(attach Form 8825)*	2		
3 Net income (loss) from other rental activities	3		

JA 70

Income (Loss)	4 Interest income	4	14,396.	275.	
	5 Dividends: a Ordinary dividends	5a			AZ S-corp Income= 31,047 275 -233 Total 31,089
	b Qualified dividends	5b			
	6 Royalties	6			
	7 Net short-term capital gain (loss)	7			
	8a Net long-term capital gain (loss)	8a			
	b Collectibles (28%) gain (loss)	8b			
	c Unrecaptured section 1250 gain	8c			
	9 Net section 1231 gain (loss) *(attach Form 4797)*	9	-12,206.	-233.	
	10 Other income (loss)	10			
Other Deductions	11 Section 179 deduction *(attach Form 4562)*	11			
	12a Contributions	12a	2,956.	57.	
	b Deductions related to portfolio income	12b			
	c Investment interest expense	12c			
	d Section 59(e)(2) expenditures	12d			
	e Other deductions	12e			

Credit & Credit Recapture	13a Low-income housing credit (Section 42(j)(5))	13a		
	b Low-income housing credit (other)	13b		
	c Qualified rehabilitation expenditures (rental real estate)	13c		
	d Other rental real estate credits	13d		
	e Other rental credits	13e		
	f Credit for alcohol used as a fuel	13f		
	g Other credits and credit recapture	13g	9,137.	175.
Foreign Transactions	14b Gross income from all sources	14b		
	c Gross income sourced at shareholder level	14c		
	Foreign gross income sourced at corporate level:			
	d Passive	14d		
	e Listed categories	14e		
	f General limitation	14f		
	Deductions allocated and apportioned at shareholder level:			
	g Interest expense	14g		

[Cont.] Foreign Transactions	h Other	14h		
	Deductions allocated and apportioned at corporate level to foreign source income:			
	i Passive	14i		
	j Listed categories	14j		
	k General limitation	14k		
	Other information:			
	l Foreign taxes paid	14l		
	m Foreign taxes accrued	14m		
	n Reduction in taxes available for credit *(attach schedule)*	14n		
Alternative Minimum Tax (AMT) Items	15a Post-1986 depreciation adjustment	15a	-17,782.	-340.
	b Adjusted gain or loss	15b	-1,591.	-30.
	c Depletion (other than oil and gas)	15c		
	d Oil, gas, and geothermal properties - gross income	15d		
	e Oil, gas, and geothermal properties - deductions	15e		
	f Other AMT items	15f		

Items Affecting Shareholder Basis	16a Tax-exempt interest income	16a		
	b Other tax-exempt income	16b		
	c Nondeductible expenses	16c	23,125.	442.
	d Property distributions	16d	635,529.	12,153.
	e Repayment of loans from shareholders	16e		
Other Information	17a Investment income	17a	14,396.	275.
	b Investment expenses	17b		
	c Dividend distributions paid from accumulated earnings and profits	17c		
	23 Supplemental information required to be reported separately to each shareholder:			

NOT TO BE FILED WITH THE STATE

EXHIBIT C

Wynne - 2006

	Original Return	As Adjusted
Federal Adjusted Gross Income	$ 2,745,816.00	$ 2,745,816.00
Additions to Income	$ 21,790.00	$ 21,790.00
Federal AGI plus Additions	$ 2,767,606.00	$ 2,767,606.00
Taxable Refunds	$ 11,898.00	$ 11,898.00
Other Subtractions	$ 2,732.00	$ 2,732.00
Subtotal of Subtractions	$ 14,630.00	$ 14,630.00
Two Income Subtraction	$ 1,200.00	$ 1,200.00
Total Subtractions	$ 15,830.00	$ 15,830.00
Maryland AGI	$ 2,751,776.00	$ 2,751,776.00
Deductions	$ 67,843.00	$ 67,843.00
Net Income	$ 2,683,933.00	$ 2,683,933.00
Exemption Amount	$ 16,800.00	$ 16,800.00
Taxable Net Income	$ 2,667,133.00	$ 2,667,133.00
Maryland Tax	$ 126,636.31	$ 126,636.31
Tax Credits	$ 84,550.00	$ 59,051.71

Maryland Tax After Credits	$ 42,086.31	$ 67,584.60	
Local Tax Rate	3.05%	3.20%	
Local Tax	$ 81,347.56	$ 85,348.26	
Local Credits	$ -	$ -	
Local Tax After Credits	$ 81,347.56	$ 85,348.26	
Total State and Local Tax	$ 123,433.87	$ 152,932.86	
Withholding	$ 82,793.00	$ 82,793.00	
Estimated Payments	$ 25,794.00	$ 25,794.00	
Total Payments	$ 108,587.00	$ 108,587.00	
Balance Due	$ 14,846.87	$ 44,345.86	
Payment with Return	$ 14,846.87	$ 14,847.87	
Tax Balance	$ (0.00)	$ 29,497.99	
Interest		$ 5,543.57	*
Penalty		$ 2,065.06	**
Total Balance Due		$ 37,106.62	

*Interest accrued at the statutorily imposed rate of 13% per annum from payment due date to current date (MD TG-Article Section 13-604)

**Penalty accrued at 10% (MD TG-Article Section 13-701)

EXHIBIT D

Chart summarizing Maxim Healthcare Services, Inc.'s state filings for 2006 and the Comptroller's calculation of the corresponding credit to which the [Wynnes] are entitled towards their 2006 Maryland income tax liability

[Fold-Out Exhibit, see next 3 pages]

D

Wynne
S-Corp paid Tax

	CA	IL	KY	MA	MI	MS	PA	SC	TN	WI
Taxable Income	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00
Taxable Income Other State	$ 245,063.30	$ 54,592.80	$ 6,551.11	$ 25,547.62	$ 188,628.67	$ 977.21	$ 196,874.76	$ -	$ 36,847.61	$ -
Revised Taxable Income	$ 2,422,069.70	$ 2,612,540.20	$ 2,660,581.89	$ 2,641,585.38	$ 2,478,504.33	$ 2,666,155.79	$ 2,470,258.24	$ 2,667,133.00	$ 2,630,285.39	$ 2,667,133.00
MD Tax	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00
Tax on Revised Tax Income	$ 114,995.81	$ 124,043.16	$ 126,325.14	$ 125,422.81	$ 117,676.46	$ 126,589.90	$ 117,284.77	$ 126,636.32	$ 124,886.06	$ 126,636.32
Tentative Tax Credit	$ 11,640.19	$ 2,592.84	$ 310.86	$ 1,213.19	$ 8,959.54	$ 46.10	$ 9,351.23	$ (0.32)	$ 1,749.94	$ -
Tax in Other State	$ 2,620.44	$ 818.90	$ 398.57	$ 1,149.65	$ 3,583.94	$ 46.86	$ 962.71	$ -	$ 2,395.10	$ 9.00
Credit	$ 2,620.44	$ 818.90	$ 310.86	$ 1,149.65	$ 3,583.94	$ 46.10	$ 962.71	$ -	$ 1,749.94	$ -
Revised Tax Calculation										
Revised Taxable Income	$ 2,422,069.70	$ 2,612,540.20	$ 2,660,581.89	$ 2,641,585.38	$ 2,478,504.33	$ 2,666,155.79	$ 2,470,258.24	$ 2,667,133.00	$ 2,630,285.39	$ 2,667,133.00
Minus $3,000	$ 2,419,069.70	$ 2,609,540.20	$ 2,657,581.89	$ 2,638,585.38	$ 2,475,504.33	$ 2,663,155.79	$ 2,467,258.24	$ 2,664,133.00	$ 2,627,285.39	$ 2,664,133.00
Multiple By .0475	$ 114,905.81	$ 123,953.16	$ 126,235.14	$ 125,332.81	$ 117,586.46	$ 126,499.90	$ 117,194.77	$ 126,546.32	$ 124,796.06	$ 126,546.32
Add $90	$ 114,995.81	$ 124,043.16	$ 126,325.14	$ 125,422.81	$ 117,676.46	$ 126,589.90	$ 117,284.77	$ 126,636.32	$ 124,886.06	$ 126,636.32
Revised Tax	$ 114,995.81	$ 124,043.16	$ 126,325.14	$ 125,422.81	$ 117,676.46	$ 126,589.90	$ 117,284.77	$ 126,636.32	$ 124,886.06	$ 126,636.32

S-Corp filed Composite Returns

	AL	CA	CO	CT	DE	GA	ID	IL	IN	IO
Taxable Income	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00
Taxable Income Other State	$ 13,474.00	$ 245,032.00	$ 57,622.00	$ 34,264.00	$ 11,361.00	$ 33,873.00	$ 646.00	$ 54,593.00	$ 12,867.00	$ 1,263.00
Revised Taxable Income	$ 2,653,659.00	$ 2,422,101.00	$ 2,609,511.00	$ 2,632,869.00	$ 2,655,772.00	$ 2,633,260.00	$ 2,666,487.00	$ 2,612,540.00	$ 2,654,266.00	$ 2,665,870.00
MD Tax	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00
Tax on Revised Tax Income	$ 125,996.30	$ 114,997.30	$ 123,899.27	$ 125,008.78	$ 126,096.67	$ 125,027.35	$ 126,605.63	$ 124,043.15	$ 126,025.14	$ 126,576.33
Tentative Tax Credit	$ 639.70	$ 11,638.70	$ 2,736.73	$ 1,627.22	$ 539.33	$ 1,608.65	$ 30.37	$ 2,592.85	$ 610.87	$ 59.68
Tax in Other State	$ 674.00	$ 22,788.00	$ 2,668.00	$ 1,713.00	$ 676.00	$ 2,032.00	$ 49.00	$ 1,638.00	$ 437.00	$ 113.00
Credit	$ 639.70	$ 11,638.70	$ 2,668.00	$ 1,627.22	$ 539.33	$ 1,608.65	$ 30.37	$ 1,638.00	$ 437.00	$ -
Revised Tax Calculation										
Revised Taxable Income	$ 2,653,659.00	$ 2,422,101.00	$ 2,609,511.00	$ 2,632,869.00	$ 2,655,772.00	$ 2,633,260.00	$ 2,666,487.00	$ 2,612,540.00	$ 2,654,266.00	$ 2,665,870.00
Minus $3,000	$ 2,650,659.00	$ 2,419,101.00	$ 2,606,511.00	$ 2,629,869.00	$ 2,652,772.00	$ 2,630,260.00	$ 2,663,487.00	$ 2,609,540.00	$ 2,651,266.00	$ 2,662,870.00
Multiple By .0475	$ 125,906.30	$ 114,907.30	$ 123,809.27	$ 124,918.78	$ 126,006.67	$ 124,937.35	$ 126,515.63	$ 123,953.15	$ 125,935.14	$ 126,486.33
Add $90	$ 125,996.30	$ 114,997.30	$ 123,899.27	$ 125,008.78	$ 126,096.67	$ 125,027.35	$ 126,605.63	$ 124,043.15	$ 126,025.14	$ 126,576.33
Revised Tax	$ 125,996.30	$ 114,997.30	$ 123,899.27	$ 125,008.78	$ 126,096.67	$ 125,027.35	$ 126,605.63	$ 124,043.15	$ 126,025.14	$ 126,576.33

TOTAL ALLOWABLE CREDIT $ 59,051.81 *

*This figure also includes the $618 the taxpayer paid to Arizona which was reported correctly on the original return

OK	OR	PA	RI	SC
$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00
$ 11,167.00	$ 12,882.00	$ 48,799.00	$ 5,434.00	$ 12,086.00
$ 2,655,966.00	$ 2,654,251.00	$ 2,618,334.00	$ 2,661,699.00	$ 2,655,047.00
$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00
$ 126,105.89	$ 126,024.42	$ 124,318.37	$ 126,378.20	$ 126,062.23
$ 530.12	$ 611.58	$ 2,317.63	$ 257.80	$ 573.77
$ 670.00	$ 1,159.00	$ 1,498.00	$ 435.00	$ 846.00
$ 530.12	$ 611.58	$ 1,498.00	$ 257.80	$ 573.77
$ 2,655,966.00	$ 2,654,251.00	$ 2,618,334.00	$ 2,661,699.00	$ 2,655,047.00
$ 2,652,966.00	$ 2,651,251.00	$ 2,615,334.00	$ 2,658,699.00	$ 2,652,047.00
$ 126,015.89	$ 125,934.42	$ 124,228.37	$ 126,288.20	$ 125,972.23
$ 126,105.89	$ 126,024.42	$ 124,318.37	$ 126,378.20	$ 126,062.23
$ 126,105.89	$ 126,024.42	$ 124,318.37	$ 126,378.20	$ 126,062.23

AK	DC	LA	NJ	NY	TOTAL
$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	
$ 3,120.07	$ 4,017.05	$ 5,952.58	$ 45,036.70	$ 52,331.66	
$ 2,664,012.93	$ 2,663,115.95	$ 2,661,180.42	$ 2,622,096.30	$ 2,614,801.34	
$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	
$ 126,488.11	$ 126,445.51	$ 126,353.57	$ 124,497.07	$ 124,150.56	
$ 147.89	$ 190.49	$ 282.43	$ 2,138.93	$ 2,485.44	
$ 177.36	$ 400.70	$ 388.21	$ 4,053.31	$ 3,924.88	
$ 147.89	$ 190.49	$ 282.43	$ 2,138.93	$ 2,485.44	[redacted]
$ 2,664,012.93	$ 2,663,115.95	$ 2,661,180.42	$ 2,622,096.30	$ 2,614,801.34	
$ 2,661,012.93	$ 2,660,115.95	$ 2,658,180.42	$ 2,619,096.30	$ 2,611,801.34	
$ 126,398.11	$ 126,356.51	$ 126,263.57	$ 124,407.07	$ 124,060.56	
$ 126,488.11	$ 126,445.51	$ 126,353.57	$ 124,497.07	$ 124,150.56	
$ 126,488.11	$ 126,445.51	$ 126,353.57	$ 124,497.07	$ 124,150.56	

KS	ME	MA	MI	MN	MS
$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,667,133.00	$ 2,66
$ 3,212.00	$ 3,182.00	$ 25,541.00	$ 20,277.00	$ 7,392.00	$
$ 2,663,921.00	$ 2,663,951.00	$ 2,641,592.00	$ 2,646,856.00	$ 2,659,741.00	$ 2,66
$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 126,636.00	$ 12
$ 126,483.75	$ 126,485.17	$ 125,423.12	$ 125,673.16	$ 126,285.20	$ 12
$ 152.25	$ 150.83	$ 1,212.88	$ 962.84	$ 350.80	$
$ 206.00	$ 271.00	$ 1,354.00	$ 791.00	$ 580.00	$
$ 152.25	$ 150.83	$ 1,212.88	$ 791.00	$ 350.80	$
$ 2,663,921.00	$ 2,663,951.00	$ 2,641,592.00	$ 2,646,856.00	$ 2,659,741.00	$ 2,66
$ 2,660,921.00	$ 2,660,951.00	$ 2,638,592.00	$ 2,643,856.00	$ 2,656,741.00	$ 2,66
$ 126,393.75	$ 126,395.17	$ 125,333.12	$ 125,583.16	$ 126,195.20	$ 12
$ 126,483.75	$ 126,485.17	$ 125,423.12	$ 125,673.16	$ 126,285.20	$ 12
$ 126,483.75	$ 126,485.17	$ 125,423.12	$ 125,673.16	$ 126,285.20	$ 12

EXHIBIT E

COMPTROLLER
of MARYLAND
Serving the People

Peter Franchot
Comptroller

James T. Loftus
Director
Compliance Division

NOTICE OF FINAL DETERMINATION

READ THIS NOTICE WITH CARE:
YOU MUST ACT WITHIN 30 DAYS OF
THIS NOTICE
DATE TO PRESERVE FURTHER
APPEAL RIGHTS.

Brian and Karen Wynne
15037 Bushy Park Road
Woodbine, MD 21797

TIN: XXX-XX-[redacted]
Tracking No.: 59300
Tax Period: 2006
Date: October 6, 2008

2005 Amounts Assessed		**2005 Final Amounts Due**
Tax:	**$ 7,524.59**	**$ 10,223.75**
Interest:	**$ 1,907.29**	**$ 3,326.99**
Penalty:	**$ 752.46**	**$ 1,022.38**
Total:	**$ 10,184.34**	**$ 14,573.12**
Offsets Received:		**($ 14,573.12)**
Amount Due:		**$ 0.00**

2006 Amounts Assessed		2006 Final Amounts Due	
Tax:	**$ 83,931.87**	**$**	**29,498.76**
Interest:	**$ 7,289.03**	**$**	**5,543.57**
Penalty:	**$ 8,393.19**	**$**	**2,065.06**
Total:	**$ 99,614.09**	**$**	**37,107.39**
Offsets Received:		**($**	**26,530.26)**
Amount Due:			**$10,577.13**

This is the Comptroller's final determination on your request for revision of the two assessments for tax year 2005 dated January 24, 2008 and the assessment for tax year 2006 dated December 6, 2007, pursuant to Maryland Tax-General Article, §13-508(c).

ISSUE(S)

The primary issues are: (1) whether the Comptroller of Maryland correctly adjusted the taxpayer's local income tax due and (2) whether the Comptroller of Maryland correctly reduced the amount of credit the taxpayer's reported for income tax paid to other states.

BACKGROUND

The Comptroller of Maryland assessed the taxpayer in 2005 and 2006 after adjusting the taxpayer's local income tax calculation to use Caroline County's rate rather than Carroll County's rate. The Comptroller also adjusted the taxpayer's 2006 return by disallowing the portion of the tax credit for income tax paid to other states in instances where the taxpayer did not complete a Form 502CR for each state. The taxpayer appealed

the assessments and a hearing was held on May 27, 2008.

TESTIMONY

Pamela Porter, representative of the Comptroller of Maryland's Revenue Administration Division, appeared on behalf of the Comptroller. She testified to the above-mentioned adjustments. With regard to 2005, Ms. Porter testified that the taxpayer originally filed their return noting Carroll County as their locality and using a local income tax rate of 3.05%. In October of 2006, the Comptroller's office erroneously believed that the taxpayer's locality should have been Caroline County, adjusted the taxpayer's local income tax rate to 2.63% and sent the taxpayer a check for $7,524.77. This taxable amount is almost identical to the tax due on the two assessments dated January 24, 2007 for tax year 2005.

With regard to 2006, the same locality issue exists as noted in the paragraph immediately above. In addition, Ms. Porter informed the taxpayer's representative, Ms. Padousis, that the Comptroller's office denied the credit for income tax paid to other states in instances that a composite Form 502CR was filed for all states a completed Form 502CR was not filed. Ms. Porter informed the taxpayer that the Comptroller's office would accept correctly completed Form 502CRs and adjust the account.

Ms. Renee Padousis attended the hearing on behalf of the taxpayer. With regard to 2005, she said that she knew that an issue existed connected to local tax, but that she would have to consult with the client about how they would like to proceed with this issue.

Ms. Padousis expressed the taxpayer's position that the 2006 denial of the credit for income taxes paid to other states was erroneous. Ms. Padousis asserted that the applicable law is found in Maryland Tax-General Article §10-703(c)(2) and that the credit is based on tax that an S Corporation pays to another state.

After the hearing, the taxpayer re-submitted the composite cover sheet and provided Form 502CRs for each state noting only lines 2, Taxable Net Income, and Line 7, state tax actually paid, and concluding that the credit allowable was always equal to the tax actually paid.

Ms. Padousis also confirmed the hearing officer's belief that the taxpayer's locality should have been Howard County, not Carroll County as filed or Caroline County as originally adjusted by the Comptroller's office. The adjustment to Howard County's local tax rate of 3.20% further increased the taxpayer's liability. The taxpayer is not contesting the legality of that issue and therefore it will not be discussed in the subsequent analysis.

LAW AND APPLICATION OF LAW TO FACT

The sole issue being contested is whether the amount of credit claimed by the taxpayer for taxes paid to other states is correct as a matter of the law. Maryland Tax-General Article §10-703 provides the limitations for taxpayers to claim a credit for tax paid by a Maryland resident to another state. Generally, a Maryland resident may claim only a credit of the lesser of "(i) the amount of allowable tax on income that the resident paid to another state; or (ii) an amount that does not reduce the State [of Maryland] income tax to

an amount less than would be payable if the income subjected the tax in the other state were disregarded." Tax-General Article §10-703(c)(1). The court in *Comptroller of Treasury v. Hickey, 114 Md. App. 388, 689 A.2d 1316* (1997)., articulated that a main purpose of §10-703(c)(1) is to ensure that Maryland collects the same amount of income tax, even though another state may impose a higher rate on the income allocable to that state. Specifically speaking about §10-703(c)(1)(ii), the *Hickey* court stated that this law's limitations are provided so that Maryland receives, at a minimum, the income tax due on income attributable to Maryland regardless of another state's method or rate of calculation.

Tax-General Article §10-703(c)(1) is also conveyed to taxpayers through Form 502CR and its instructions. Part A of Form 502CR, titled "Tax Credits for Income Taxes Paid to Other States," requires that taxpayers complete an eight step formula that results in the taxpayer arriving at the allowable credit for each state. The allowable credit, consistent with the Tax-General Article §10-703(c)(1), is equal to the smaller of the tax liability actually paid or the reduction in Maryland tax resulting from the exclusion of income in the other state. The instructions to Form 502CR, Part A, under the bolded subheading "Members of Pass-through Entities," inform taxpayers that when a S corporation files a composite return on behalf of its shareholders, Maryland resident partners may claim a credit for their share of taxes paid and instructs taxpayers to complete a separate form 502CR for each state and total the amounts on line 8 of each form to get the total credit amount.

This methodology is consistent with Tax-General Article §10-703(c)(1) and suitable for taxpayers who had pass-through entities remit their income tax withholding to other states on their behalf. Some states, however, do not recognize pass-through treatment. In those states, the S corporation must itself file and pay tax at the entity level rather than filing a composite return on behalf of shareholders and withholding and remitting its shareholders' income tax. As the taxpayer correctly points out, Tax-General Article §10-703(c)(1) provides an exemption to calculating the credit in the manner stated in the two paragraphs immediately above. Tax-General Article §10-703(c)(2) provides that the credit allowed to an individual shareholder in instances where an S corporation pays tax to another state "(i) may not exceed that shareholder's pro rata share of the tax; and (ii) will not be allowed for another state's income taxes or taxes based on income."

Tax-General Article §10-703(c)(2) is conveyed to taxpayers through Form 502CR and its instructions. Similar to the instructions for "Members of Pass-through Entities," the instructions to Form 502CR contain a section titled "Shareholders of S Corporations," where taxpayers are instructed to complete a separate Form 502CR for each state. However, taxpayers who are shareholders of S corporations are instructed to replace step two and step seven of the eight step formula with calculations derived by multiplying the taxpayer's stock ownership percentage by the corporate taxable income to calculate step two and by multiplying the stock ownership percentage by corporate tax paid to calculate step seven. By following these instructions, taxpayers

remain compliant with Tax-General Article §10-703(c)(2).

Maxim Healthcare Services, the S corporation of which the taxpayer is a member, files its state income tax returns in two different methods. For those states that adhere to pass-through treatment of S corporations, Maxim files a composite return on behalf of its members. For those states that do not recognize pass-through treatment, Maxim itself pays the corporate income tax.

The taxpayer states that Tax-General Article §10-703(c)(2) is the applicable portion of the law since Tax-General Article §10-703(c)(1) says that except in paragraph (2) of this subsection, this paragraph (1) will apply. The taxpayer notes that Tax-General Article §10-703(c)(2) provides that the Maryland credit for taxes paid to other states is to be determined "based on the tax that an S corporation pays to another state." The taxpayer asserts that "all taxes paid by the S Corporation on behalf of its shareholders have been allocated on a pro-rata basis," and therefore the taxpayer has correctly calculated a credit of $84,550.00 in accordance with Tax-General Article §10-703(c)(2).

The Comptroller disagrees with the taxpayer's rationale for their calculation of the tax credit. The Comptroller reads the language of Tax-General Article §10-703(c)(2) as being applicable only in instances where an S corporation has directly paid tax to another state that does not recognize pass-through treatment. The Comptroller concludes that Tax-General Article §10-703(c)(2) is not appropriate in those circumstances where the S corporation has acted as a pass-through entity and has remitted tax withheld from their

members to other states on their members behalf. The Comptroller's treatment of taxing non-resident members of S corporations is consistent with this approach. Under Tax-General Article §10-102.1, Maryland provides that S corporations are pass-through entities and that the tax imposed on members of S corporations "shall be treated as a tax imposed on the nonresident or nonresident entity member that paid on behalf of the nonresident entities by the pass-though entity."

In order to claim a credit for income taxes paid to states that recognize pass-through treatment, Tax-General Article §10-703(c)(1) is applicable and the taxpayer should have completed the eight step formula contained in Part A of Form 502CR. This calculation results in the taxpayer being eligible for a credit equal to the smaller of the tax liability actually paid or the reduction in Maryland tax resulting from the exclusion of income in the other state. Instead, the taxpayer incorrectly determined its tax liability by simply adding the tax liability actually paid in each state $62,760.00. The taxpayer failed to follow the statute and determine the reduction in Maryland tax resulting from the exclusion of income in the other state and whether that figure was less than the tax actually paid. The Comptroller's calculations show that this credit should have been $42,564.09

In order to claim a credit for income taxes paid to states that do not adhere to pass-through treatment, Tax-General Article §10-703(c)(2) is applicable and the taxpayer should have completed Part A of Form 502CR's eight step formula, but substituted step two and seven of the eight step formula as described above

and in the instructions to Form 502CR titled "Shareholders of S Corporations". The taxpayer's cover sheet and Form 502CRs do not conform to this calculation, but rather claim a credit amount of $21,790.00. The Comptroller's calculations show that this credit should have been equal to $16,487.72.

When the form 502CRs for each state is completed to comply with the law, the credit resulting is equal to $59,051.81. The Comptroller has provided the taxpayer credit for taxes paid to other states for 2006 in that amount.

DETERMINATION

The assessment is revised and affirmed in the amounts noted above.

APPEAL

If you are dissatisfied with this final determination, AN APPEAL MUST BE TIMELY FILED IN THE MARYLAND TAX COURT within 30 days of the date shown above. DO NOT FILE AN APPEAL WITH THE COMPTROLLER OF MARYLAND. If you do not appeal in accordance with the procedures of the MARYLAND TAX COURT within 30 days, this final determination will become an absolute liability, which must be promptly paid, and the payment may not be refunded for any reason. Appropriate forms for use in filing appeals may be obtained from the MARYLAND TAX COURT at 301 West Preston Street, Suite 1513, Baltimore, Maryland 21201, telephone number (410) 767-4830.

/s/Benjamin Gugliotta
Benjamin Gugliotta, Jr., Esq.
Hearing Officer
(410) 767-4766
bgugliotta@comp.state.md.us

cc: Renee Padousis

Fax: 410-333-7745
Email: cdhearings@comp.state.md.us
Toll Free: 1-888-615-0268

301 West Preston Street • Baltimore, MD 21201-2383 Maryland Relay 711 • TTY (410) 767-1967 • http://compnet.comp.state.md.us./compliance

EXHIBIT F

TO BE FILED IN DUPLICATE **Various Appeals Petition**

MARYLAND TAX COURT
301 W. Preston Street, Suite 1513
Baltimore, Maryland 21201
410-767-4830 (Toll Free: 1-866-223-6075)
internet: www.txcrt.state.md.us

CASE NO. 08-IN-OO-0791

SSN. [redacted]
(Income Tax Appeals only)

[Filed October 24, 2008]

Brian and Karen Wynne Petitioners	)
vs.	)
Comptroller of Maryland Respondent	)

PETITION OF APPEAL

1. This is an appeal from: (please check one)
2. Type of Tax Being Appealed:
   (Please attach a copy of the decision from which you are appealing)

X	An Assessment	X	Income/Withholding Tax

___	An Allowance/Disallowance of a Claim for Refund of Tax	____	Sales/Use Tax
___	Denial of Claim for Property Tax Credit	____	Transfer/Recordation Tax
_X_	Other: Notice of Final Determination	____	Other: _____

3. The amount in controversy is: $25.498.19 plus penalties and interest related thereto.

4. The tax year(s) involved: 2006

5. The date of the assessment notice or action complained of was October 6, 2008.

6. Please set out the reason(s) you believe that the action taken against you was illegal or erroneous. Any additional questions to be reviewed by the Court should also be provided. Continue on the back if necessary.

SEE ATTACHED

Signature /s/ Attorney for Petitioners Date: 10/23/08
(Capacity)

Signature /s/ Attorney for Petitioners Date: 10-23-08
(Capacity)

Name, Mailing Address and Telephone: (Please Print or Type)

Robert A. Snyder, Jr., Esquire, and Matthew F. Penater, Esquire, Thomas & Libowitz, P.A. 100 Light

Street, Suite 1100, Baltimore, Maryland 21202; (410) 752-2468

PLEASE NOTE:

If the petitioner is an individual this petition should be signed by said petitioner or an attorney. If petitioner is a partnership, it should be signed by an attorney for the partnership or by any partner. If petitioner is a corporation, it should be signed by the corporation's attorney or by any officer of the corporation. The person signing should designate the capacity in which he/she signs. In any instance, the attorney must be duly admitted to practice before the Court of Appeals.

For the Hearing Impaired: MRS 1-800-735-2258

ATTACHMENT TO PETITION OF APPEAL
LINE #6

Origin of Case:

This appeal is brought in response to an assessment and Notice of Final Determination filed against the Petitioners by the Comptroller of Maryland (the "Comptroller"). The nature of this case is founded on the calculation of the Petitioners' credit for taxes paid to other states by an S corporation of which one of the Petitioners is a shareholder, pursuant to Md. Code Ann., [Tax-General] § 10-703.

Facts:

The Petitioners are Maryland residents. One of the Petitioners owns stock in a corporation (the "S Corporation"), which has made an election under the Internal Revenue Code § 1362(a) to be treated as a subchapter S corporation. In 2006, the S Corporation filed income tax returns in 25 states. Composite income tax returns were filed in states which recognize pass-through taxation of S corporations. Corporate income tax returns were filed in states which did not recognize such pass-through taxation. The S Corporation remitted the appropriate state income tax due to each state with the composite return or corporate return. The Petitioners claimed their pro-rata share of taxes paid to other states with both the composite and corporate returns as a credit for taxes paid to other states on the Petitioners' 2006 Maryland Form 502. In its Notice of Final Determination, the Comptroller reduced the Petitioners' credit claiming the Petitioners erroneously calculated the credit. The Comptroller claims that: 1) Md. Code Ann., [Tax-General] § 10-703

requires that the credit for state taxes paid by S corporations filing composite returns must be calculated under Md. Code Ann., [Tax-General] § 10-703(c)(1); and that 2) the credit for state taxes paid by S corporations filing corporate returns must be calculated under Md. Code Ann., [Tax-General] § 10-703(c)(2), but is still subject to the limitation of Md. Code Ann., [Tax General] § 10-703(c)(1). It is Petitioners' position that calculation of the credit for all taxes paid to other states by the S Corporation is governed exclusively by Md. Code Ann., [Tax-General] § 10-703(c)(2) and is neither subject to nor governed by the limitation of Md. Code Ann., [Tax-General] § 10-703(c)(1).

Questions for the Court:

1. When an S corporation pays taxes to another state, is there a difference for purposes of computing the credit under Md. Code Ann., [Tax-General] § 10-703(c)(2) as to whether the taxes are paid with a composite return or a corporate return filed with such other state?

2. Is the credit allowed under Md. Code Ann., [Tax-General] § 10-703(c)(2) for taxes paid to another state by an S corporation subject to the limitation imposed under Md. Code Ann., [Tax-General] § 10-703(c)(1)?

Assertion:

The Comptroller of Maryland erroneously assessed the Petitioners 2006 income tax liability by reducing the Petitioners' credit for taxes paid to other states in

violation of the clear and unambiguous language of Md. Code Ann., [Tax-General] § 10-703(c)(1) & (2).

EXHIBIT G

IN THE
MARYLAND TAX COURT

APPEAL NO. 08-IN-OO-0791

[Dated April 1, 2009]

BRIAN & KAREN WYNNE	)
	)
Petitioners	)
	)
v.	)
	)
COMPTROLLER OF THE TREASURY	)
	)
Respondent	)
	)

AFFIDAVIT OF PAMELA L. PORTER

I, Pamela L. Porter, hereby declare under penalties of perjury that to the best of my knowledge, information and belief, the following facts are true and correct:

1. My name is Pamela L. Porter. I am over the age of eighteen years and competent to testify in this matter.

2. I am a revenue administrator within the Revenue Administration Division of the Office of the Comptroller of Maryland.

3. I have been an employee of the Office of the Comptroller of Maryland for 25 years.

4. One of my responsibilities is to serve as a liaison between the Comptroller's Office and the Attorney General's Office on income tax appeals filed by taxpayers in the Maryland Tax Court. In conjunction with discharging this responsibility, I am familiar with the interpretation, enforcement, and application of Maryland income tax laws and regulations by the Office of the Comptroller.

5. For purposes of claiming a credit by a Maryland resident for taxes paid to another state, the long-standing, administrative interpretation, enforcement and application by the Office of the Comptroller of the applicable statutory provisions requires that in order to claim a credit for income taxes paid to states that recognize pass through treatment of an S Corporation, Tax General Art., § 10-703(c)(1) is applicable.

6. For purposes of claiming a credit by a Maryland resident for taxes paid to another state, the long-standing, administrative interpretation by the Office of the Comptroller of the applicable statutory provisions requires that in order to claim a credit for income taxes paid to states that do not recognize pass through treatment of an S Corporation, Tax-General Art., § 10-703(c)(2) is applicable.

7. I have reviewed the Petitioners 2006 income tax returns and the assessment imposed by the Office of the Comptroller for 2006. The assessment, which the Petitioners have appealed in the above captioned matter, was determined and calculated consistent with the Office of the Comptroller's long-standing interpretation and application of Tax-General Art.,§§ 10-703(c)(1) & (2).

I SOLEMNLY AFFIRM UNDER THE PENALTIES OF PERJURY THAT THE CONTENTS OF THE FOREGOING PAPER ARE TRUE TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF.

Dated: April 1, 2009

/s/Pamela L. Porter **Pamela L. Porter**

EXHIBIT H

FORM 502CR
MARYLAND
INCOME TAX CREDITS FOR INDIVIDUALS
ATTACH TO YOUR TAX RETURN
2006

SOCIAL SECURITY #		SPOUSE'S SOCIAL SECURITY #
Your First Name	Initial	Last Name
Spouse's First Name	Initial	Last Name

Read Instructions for Form 502CR	*Note: You must complete and submit both pages 1 and 2 of this form to receive credit for the items listed.*

PART A - TAX CREDITS FOR INCOME TAXES PAID TO OTHER STATES

If you were a part-year resident, you may not claim a credit for tax paid on nonresident income you subtracted on line 13 of Form 502.

1. Enter your taxable net income from line 22, Form 502 1

2. Taxable net income in other state. Write on this line only the net income which is taxable in both the other state and Maryland. If you are taxed in the other state on income which is not taxable in Maryland, do not include that amount here 2

NOTE: When the tax in the other state is a percentage of a tax based on your total income regardless of source, you must apply the same percentage to your taxable income in the other state to determine the income taxable in both states.

3. Revised taxable net income (Subtract line 2 from line 1.) If less than zero, enter zero. 3

4. Enter the Maryland tax from line 24, Form 502. This is the Maryland tax based on your total income for the year. 4

5. Tax on amount on line 3. Compute the Maryland tax that would be due on the revised taxable net income by using the Maryland Tax Table or Computation Worksheet contained in the instructions for Form 502. Do not include the local income tax. 5

6. Tentative tax credit (Subtract line 5 from line 4.) If less than zero, enter zero. 6

7.	State tax shown on the tax return filed with the state of [ ] Enter 2-letter state code 2-letter state code must be entered for credit to be allowed. Enter the amount of your 2006 income tax liability (after deducting any credits for personal exemptions) to a state other than Maryland. Do not enter state tax withheld from your W-2 forms. It is important that a copy of the tax return that was filed with the other state be attached to your Maryland return.	7	
8.	Credit for income tax paid to other state. Your credit for taxes paid to another state is the smaller of the tax actually paid (line 7) or the reduction in Maryland tax resulting from the exclusion of income in the other state (line 6). Write the smaller of line 6 or line 7 here and on line 1, Part G, page 2	8	

PART B - CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

1.	Enter your federal adjusted gross income from line 1 of Form 502 or line 17, column 1 of Form 505 or Form 515	1	
2.	Enter your federal Child and Dependent Care Credit from federal Form 2441 or 1040A, Schedule 2	2	
3.	Enter the decimal amount from the chart in the instructions that applies to the amount on line 1	3	

4. Multiply line 2 by line 3. Enter here and on line 2, Part G, page 2	4		

PART C - QUALITY TEACHER INCENTIVE CREDIT

		Taxpayer A		Taxpayer B	
1. Enter the Maryland public school system in which you teach		Name of Public School System - Maryland		Name of Public School System - Maryland	
2. Enter amount of tuition paid to: Name of Institution	2				
3. Enter amount of tuition reimbursement	3				
4. Subtract line 3 from line 2	4				
5. Maximum credit	5	1500	00	1500	00
6. Enter the lesser of line 4 or line 5 here	6				
7. Total (Add amounts from line 6, for Taxpayers A and B.) Enter here and on line 3, Part G, page 2	7				

PART D - CREDIT FOR AQUACULTURE OYSTER FLOATS

1. Enter the amount paid to purchase an aquaculture oyster float(s)
Enter here and on line 4 of Part G below 1

PART E - LONG-TERM CARE INSURANCE CREDIT: (this is a ONE-TIME credit)

Answer the questions and see instructions below before completing Columns A through E for each person for whom you paid long-term care insurance premiums.

Question 1 - Did the insured individual have long-term care insurance prior to July 1, 2000? ..... Yes ☐ No ☐

Question 2 - Is the credit being claimed for the insured individual in this year by any other taxpayer? ..... Yes ☐ No ☐

Question 3 - Has credit been claimed for the insured individual in any other tax year? ..... Yes ☐ No ☐

If you answered YES to any of the above questions, that insured person does NOT qualify for the credit.

Complete Columns A through D only for insured individuals who qualify for credit. Enter in Column E the lesser of the amount of premium paid for each insured person or:

$280 for those insured that are 40 or less, as of 12/31/06

$500 for those insured that are over age 40, as of 12/31/06.

Add the amounts in Column E and enter the total on line 5 (TOTAL) and Part G, line 5.

Column A Name of Qualifying Insured Individual	Age	Column B Social Security No. Of Insured	Column C Relationship to Taxpayer	Column D Amount of Premium Paid	Column E Credit Amount
1.					1.
2.					2.
3.					3.
4.					4.
5. TOTAL					5.

PART F - CREDIT FOR PRESERVATION AND CONSERVATION EASEMENTS

1. Enter the total of the current year donation amount, and any carryover from prior year(s)	1	
2. Enter the amount of any payment received for the easement during 2006	2	
3. Subtract line 2 from line 1	3	
4. Enter the amount from line 24 of Form 502, line 32c of Form 505 or line 33 of Form 515, or $5,000, whichever is less	4	
5. Enter the lesser of lines 3 or 4 here and on line 6 of Part G below. (If you itemize deductions, see Instruction 14.)	5	
6. Excess credit carryover. Subtract line 5 from line 3	6	

PART G - INCOME TAX CREDIT SUMMARY

1. Enter the amount form Part A, line 8 (If more than one state, see instructions)	1	
2. Enter the amount form Part B, line 4	2	
3. Enter the amount form Part C, line 7	3	
4. Enter the amount form Part D, line 1	4	

5. Enter the amount form Part E, line 5	5		
6. Enter the amount from Part F, line 5	6		
7. Enter the amount form Section 2, line 4 of Form 502H, Attach Form 502H.	7		
8. Total (Add lines 1 through 7.) Enter this amount on line 27 of Form 502, line 35 of Form 505 or line 36 of Form 515	8		

PART H - REFUNDABLE INCOME TAX CREDITS

1. Neighborhood Stabilization Credit. Enter the amount and attach certification.	1		
2. Heritage Structure Rehabilitation Tax Credit (See instructions for Form 502H.) Attach certification.	2		
3. Refundable Business Income Tax Credit (See instructions for Form 500CR.) Attach 500 CR	3		
4. IRC Section 1341 Repayment Credit. (See Instructions) Attach documentation	4		

5. Form 1041 Schedule K-1 Nonresident PTE tax (See instructions for required attachments)	5		
6. Total (Add lines 1 through 5.) Enter this amount on line 44 of Form 502, line 47 of Form 505, or line 54 of Form 515	6		

EXHIBIT I

INSTRUCTIONS FOR
FORM 502CR 2006

INCOME TAX CREDITS FOR INDIVIDUALS

GENERAL INSTRUCTIONS

Purpose of Form. Form 502CR is used to claim personal income tax credits for individuals.

You may report the following tax credits on this form: the **Credit for Income Taxes Paid to Other States, Credit for Child and Dependent Care Expenses, Quality Teacher Incentive Credit, Long-Term Care Insurance Credit, Credit for Preservation and Conservation Easements, Credit for Aquaculture Oyster Floats, the Heritage Structure Rehabilitation Tax Credit, the Neighborhood Stabilization Credit, IRC Section 1341 Repayment Credit, Form 1041 Schedule K-1 Nonresident PTE Tax, and Refundable Business Income Tax Credit from Form 500CR.**

The Neighborhood Stabilization Credit, a portion of the Heritage Structure Rehabilitation Tax Credit, certain business tax credits from Form 500CR and the IRC Section 1341 Repayment Credit are refundable. The balance of the Heritage Structure Rehabilitation Tax Credit and all of the other credits may not exceed the state income tax.

Excess credit for preservation and conservation easements and for non-refundable heritage structure rehabilitation expenses may be carried forward to the

next tax year. Excess amounts of the other credits cannot be carried forward.

Name and Other Information. Type or print the name(s) as shown on Form 502, Form 505 or Form 515 in the designated area. Enter the social security number for each taxpayer.

When and Where to File. Form 502CR must be attached to the annual return (Form 502, 505 or 515) and filed with the Comptroller of Maryland, Revenue Administration Division, Annapolis, Maryland 21411-0001.

PART A - CREDIT FOR INCOME TAXES PAID TO OTHER STATES

If you are a Maryland resident and you paid income tax to another state, you may be eligible for a credit on your Maryland return. Nonresidents (filing Form 505 or Form 515) are not eligible for this credit.

Find the state to which you paid a nonresident tax in the groups listed below. The instructions for that group will tell you if you are eligible for credit and should complete Part A of Form 502CR. You must file your Maryland income tax return on Form 502 and complete lines 1 through 24 of that form. Then complete Form 502CR Parts A and G and attach to Form 502.

A completed, signed copy of the income tax return filed in the other state must also be attached to Form 502.

CAUTION: Do not use the income or withholding tax reported on the wage and tax statement (W-2 form) issued by your employer for the credit computation.

Use the taxable income and the income tax calculated on the return you filed with the other state.

If you are claiming credit for taxes paid to more than one state, a separate Form 502CR must be completed for each state. Total the amount from each Form 502CR, Part A, line 8. Using only one summary section, record the total on Part G, line 1. Credit cannot be allowed for the local portion of the tax calculated on the return of the other state or on the Maryland return (line 31 of Form 502).

GROUP I - Nonreciprocal - Credit is taken on the Maryland resident return.

Alabama - AL	Maine - ME	Oregon - OR
Arizona AZ	Massachusetts - MA	Pennsylvania - PA (except wage income)
Arkansas - AR	Michigan - MI	Rhode Island - RI
California - CA	Minnesota - MN	South Carolina - SC
Colorado - CO	Mississippi - MS	Tennessee - TN
Connecticut - CT	Missouri - MO	Utah - UT
Delaware - DE	Montana - MT	Vermont - VT
Georgia - GA	Nebraska - NE	Virginia - VA (except wage income)
Hawaii - HI	New Hampshire - NH	Washington, DC - DC (except wage income)

Idaho - ID	New Jersey - NJ	West Virginia - WV (except wage income)
Illinois - IL	New Mexico - NM	Wisconsin - WI
Indiana - IN	New York - NY	Territories and Possessions of the United States American Samoa - AS
Iowa - IA	North Carolina - NC	Guam - GU
Kansas - KS	North Dakota - ND	Northern Mariana Island - MP
Kentucky - KY	Ohio - OH	Puerto Rico - PR
Louisiana - LA	Oklahoma - OK	U.S. Virgin Islands - VI

Group I - A Maryland resident having income from one of these states must report the income on the Maryland resident return Form 502. To claim a credit for taxes paid to the other state, complete Form 502CR and attach it and a copy of the other state's nonresident income tax return (not just your W-2 Form) to your Maryland return.

GROUP II - Reciprocal for wages, salaries, tips and commission income only.

Pennsylvania - PA	Washington, DC - DC
Virginia - VA	West Virginia - WV

Group II - Maryland has a reciprocal agreement with the states included in Group II. The agreement applies only to wages, salaries, tips and commissions. It does not apply to business income, farm income, rental income, gain from the sale of tangible property, etc. If you had such income subject to tax in these states, complete Form 502CR and attach it and a copy of the other state's nonresident income tax return (not just your W-2 Form) to your Maryland return.

If you had wages, plus income other than wages from a state listed in Group II, you should contact the taxing authorities in the other state to determine the proper method for filing the nonresident return.

GROUP III - No state income tax No credit allowed.

Alaska - AK
Florida - FL
Nevada - NV
South Dakota - SD
Texas - TX
Washington - WA
Wyoming - WY

Group III - You must report income from these states on your Maryland resident return. You cannot claim any credit for income earned in these states because you did not pay any income tax to the other state.

PART A - IMPORTANT NOTE FOR DUAL RESIDENTS

A person may be a resident of more than one state at the same time for income tax purposes. If you must file a resident return with both Maryland and another state, use the following rules to determine where the credit should be taken:

1. A person who is domiciled in Maryland and who is subject to tax as a resident of any of the states listed in Group I or II can claim a credit on the Maryland return (Form 502) using Part A of Form 502CR.

2. A person domiciled in any state listed in Group I or II who must file a resident return with Maryland must take the credit in the state of domicile.

PART A - SPECIAL INSTRUCTIONS

Members of Pass-through Entities - When a partnership, S corporation, limited liability company (LLC) or business trust files a composite return on behalf of its partners, shareholders or members with states in Groups I and II, Maryland resident partners, shareholders or members may claim a credit for their share of the tax paid. Attach the K-1 or other statements from Pass-through entity showing your share of the income and tax paid.

If the Maryland resident must file an individual nonresident return reporting the partnership, S corporation, LLC or business trust income, a separate Form 502CR must be completed for each state and submitted with a copy of the return filed with the other state. For both composite returns and individual returns, no credit is available for taxes paid to states in Group III, or for taxes paid to cities or local jurisdictions.

Shareholders of S Corporations - Maryland resident shareholders can claim a credit for taxes paid by an S corporation to a state which does not recognize federal S corporation treatment. A copy of the corporation return filed in the other state is required to

be attached to the Maryland return. A separate Form 502CR should be completed for each state showing the following information:

_____%	x_____	= _____
Stock ownership percentage	Corporation taxable income	Line 2, Part A, Form 502CR

_____%	x_____	= _____
Stock ownership percentage	Corporation tax	Line 7, Part A, Form 502CR

NOTE: A preliminary calculation using Form 502 must be made before calculating the credit on Form 502CR. Complete lines 1 through 24 on Form 502 to determine the amounts to be used for the 502CR computation.

The credit amount shown on line 8 of Part A, Form 502CR must then be included as an addition to income on line 5 of the Form 502 you will file.

D.C. Unincorporated Business Franchise Tax - Self-employed individuals and partners in a partnership that are subject to D.C. unincorporated business franchise tax may claim a credit on Form 502CR. A copy of the D.C. return is required for self-employed individuals and for partners a K-1 or other statement from the partnership showing the partner's share of income and the partner's share of the D.C. tax.

Installment Sales in Another State - You may be eligible for credit for taxes paid to another state for gain recognized on installment sales proceeds, even if the other state required that the total gain be recognized in an earlier tax year. Credit is allowed

against the state income tax only. The gain must have been deferred for federal tax purposes, but fully taxed in the year of the sale by another state that does not recognize the deferral. The credit allowed is the amount of the gain taxed in Maryland in the current year multiplied by the lesser of:

- the maximum Maryland state tax rate (currently 4.75%), or
- the tax rate imposed by the other state on the gain.

PART B - CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

If you were eligible for a Child and Dependent Care Credit on your federal income tax return, Form 1040 or 1040A for tax year 2006, you may be entitled to a credit on your Maryland state income tax return. The credit starts at 32.5% of the federal credit allowed, but is phased out for taxpayers with federal adjusted gross incomes above $41,000 ($20,500 for individuals who are married, but file separate income tax returns). No credit is allowed for an individual whose federal adjusted gross income exceeds $50,000 ($25,000 for married filing separately). Use the chart below to determine the decimal amount to be entered on line 3 of Part B.

PART C - QUALITY TEACHER INCENTIVE CREDIT

If you are a Maryland teacher, you may be able to claim a credit against your State tax liability for tuition paid to take graduate-level courses required to maintain certification. This credit applies to individuals who:

a. currently hold a standard professional certificate or advanced professional certificate;

b. are employed by a county/city board of education in Maryland;

c. teach in a public school and receive a satisfactory performance evaluation for teaching.

d. successfully complete the courses with a grade of B or better; and

e. have not been fully reimbursed for these expenses. Only the unreimbursed portion qualifies for the credit.

Each spouse that qualifies may claim this credit. Complete a separate column in the worksheet for each spouse.

INSTRUCTIONS

Line 1. Enter the name of the Maryland public school system in which you teach.

Line 2. Enter the amount of tuition paid for graduate-level courses for each qualifying teacher and the name of the institution(s) it was paid.

Line 3. Enter the amount received as a reimbursement for tuition from your employer.

Line 5. The maximum amount of credit allowed is $1,500 for each qualifying individual.

Line 6. The credit is limited to the amount paid less any reimbursement up to the maximum

amount allowed for each qualifying individual. Enter the lesser of line 4 or line 5.

Line 7. Enter the total of line 6, for Taxpayers A and B. Also enter this amount on line 3, Part G.

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES CHART

If your filing status is Married Filing Separately and your federal adjusted gross income is:		Decimal Amount	For all other filing statuses, if your federal adjusted gross income is:	
At Least	But less than		At least	But less than
$0-	$20,501	.3250	$0	$41,001
$20,501	$21,001	.2925	$41,001	$42,001
$21,001	$21,501	.2600	$42,001	$43,001
$21,501	$22,001	.2275	$43,001	$44,001
$22,001	$22,501	.1950	$44,001	$45,001
$22,501	$23,001	.1625	$45,001	$46,001
$23,001	$23,501	.1300	$46,001	$47,001
$23,501	$24,001	.0975	$47,001	$48,001
$24,001	$24,501	.0650	$48,001	$49,001
$24,501	$25,001	.0325	$49,001	$50,001
$25,001	or over	.0000	$50,001	or over

PART D - CREDIT FOR AQUACULTURE OYSTER FLOATS

A credit is allowed for 100% of the amounts paid to purchase a new aquaculture oyster float that is

designed to grow oysters at or under an individual homeowner's pier. The device must be buoyant and assist in the growth of oysters for the width of the pier. The credit cannot exceed $500. In the case of a joint return, each spouse is entitled to claim the credit, provided each spouse purchases or contributes to the purchase of a float.

PART E - LONG-TERM CARE INSURANCE CREDIT

A **one-time credit** may be claimed against the state income tax for the payment of qualified long-term care (LTC) insurance premiums as defined by the IRS (Publication 502) for a policy to insure yourself, or your spouse, parent, stepparent, child or stepchild, who is a resident of Maryland.

A credit may not be claimed if:

a. the insured was covered by LTC insurance prior to July 1, 2000;

b. the credit for the insured is being claimed in this year by another taxpayer; or

c. the credit is being or has been claimed in any other tax year.

The credit is equal to the LTC premiums paid with a maximum per insured of:

Amount	Age of Insured as of 12/31/06
$280	40 or less
$500	over 40 years

SPECIFIC INSTRUCTIONS

- Answer Questions 1 through 3. If you answered "yes" for any of the questions, no credit is allowed for that individual.
- Complete columns A through D of the worksheet for each qualifying insured individual who qualifies for the credit. If more space is required, attach a separate statement.
- Enter in Column E the amount of premiums paid for each qualifying insured individual up to the maximum for that age group.
- Add the amounts in Column E and enter the total on line 5. Also enter this amount on line 5, Part G.

PART F - CREDIT FOR PRESERVATION AND CONSERVATION EASEMENTS

If you donated an easement to the Maryland Environmental Trust or the Maryland Agricultural Land Preservation Foundation to preserve open space, natural resources, agriculture, forest land, watersheds, significant ecosystems, viewsheds or historic properties, you may be eligible for a credit if:

1. the easement is perpetual;
2. the easement is accepted and approved by the Board of Public Works; and
3. the fair market value of the property before and after the conveyance of the easement is substantiated by a certified real estate appraiser.

The credit is equal to the difference in the fair market values of the property reduced by payments received for the easement.

If the property is owned jointly by more than one individual such as a husband and wife, **each individual owner is entitled to the credit based on their percentage of ownership.** Individual members of a Pass-Through Entity are not eligible for this credit. The credit amount is limited to the lesser of the individual's state tax liability for that year or the maximum allowable credit of $5,000, per owner. In the case of a joint return each spouse must calculate their own state tax liability for limitation purposes. You can use the rules for filing separate returns in Instruction 8 in the Resident booklet to calculate each spouse's Maryland tax.

If the individual's allowable credit amount exceeds the maximum of $5,000 the excess may be carried forward for up to 15 years or until fully used. Complete lines 1-6 of Part F. If you itemize deductions, see Instruction 14 in the Resident booklet.

For Line 1, enter the amount by which the fair market value of the property before the conveyance of the easement exceeds the fair market value after the conveyance as substantiated by a certified real estate appraiser, plus any carryover from the prior year.

The carryover amount can be found on Part F line 6 of Form 502CR for tax year 2005.

For additional information, contact the Maryland Environmental Trust at 410-514-7900 (www.dnr.state.md.us/met), or the Maryland

Agricultural Land Preservation Foundation at 410-841-5860.

PART G - INCOME TAX CREDIT SUMMARY

This part is to summarize parts A through F and the non-refundable portion of Heritage Structure Rehabilitation tax credits. If the total from Part G, line 8 exceeds the state tax, the excess may not be refunded.

PART H - REFUNDABLE INCOME TAX CREDITS

Line 1 - NEIGHBORHOOD STABILIZATION CREDIT

If you live in the Waverly or Landsdowne sections of Baltimore City, or in the Hillendale, Northbrook, Pelham Woods, or Taylor/Dartmouth areas of Baltimore County, you may qualify for this credit. Credit for homes purchased in Baltimore City must have been applied for by December 31, 2002. Credit for homes purchased in Baltimore County must have been applied for by December 31, 2005. After certification by Baltimore City or Baltimore County, you may claim an income tax credit equal to the property tax credit granted by Baltimore City or Baltimore County. Enter the amount on line 1 of Part H and attach a copy of the certification.

Line 2 - HERITAGE STRUCTURE REHABILITATION TAX CREDIT

See instructions for Form 502H.

Line 3 - REFUNDABLE BUSINESS INCOME TAX CREDIT

See instructions for Form 500CR.

Line 4 - IRC SECTION 1341 REPAYMENT CREDIT

If you repaid an amount reported as income on a prior year tax return this year that was greater than $3,000, you may be eligible for an IRC Section 1341 Repayment credit. Attach documentation. For additional information, see Administrative Release 40.

Line 5 - FORM 1041 SCHEDULE K-1 NONRESIDENT PTE TAX

If you are the beneficiary of an estate or trust for which nonresident PTE tax was paid, you may be entitled to a credit for your share of that tax. Enter the amount on this line and attach both the Form 1041 Schedule K-1 for the estate or trust and a copy of the K-1 issued to the estate or trust by the PTE.

Line 6 - Add lines 1 through 5 and enter the total on the appropriate line of the income tax form being filed.

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IN THE
MARYLAND TAX COURT

APPEAL NO. 08-IN-OO-0791

[Dated May 28, 2009]

BRIAN AND KAREN WYNNE	)
	)
Petitioners	)
	)
v.	)
	)
COMPTROLLER OF THE TREASURY	)
	)
Respondent	)
	)

AMENDED
AGREED STATEMENT OF FACTS AND STIPULATION OF EXHIBITS

On April 15, 2009, the parties filed an Agreed Statement of Facts and Stipulation of Exhibits ("Initial Statement") with the Court. The parties wish to amend the Initial Statement by filing this Amended Agreed Statement of Facts and Stipulation of Exhibits. The parties hereby stipulate and agree for the purposes of this proceeding to the following matters. In so stipulating, the parties waive all objections to the admissibility of the stipulated facts.

1. The parties incorporate by reference the Initial Statement in its entirety and all exhibits attached thereto as originally filed with the Court on April 15, 2009, except as specifically modified herein.

2. The parties hereby delete paragraph 4 of the Initial Statement in its entirety and add the following paragraph 4 in its place:

"4. In 2006, Maxim filed income tax returns in a total of thirty-nine (39) states. Maxim filed composite income tax returns in thirty-two (32) states which recognized pass-through taxation of S corporations. Maxim also filed corporate-level income tax returns in an additional seven (7) states which did not recognize such pass-through taxation of S corporations.[1]"

Date: May 28, 2009

RESPONDENT

By its Attorney:

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---

[1] Maxim actually filed corporate-level income tax returns in fifteen (15) states, however eight (8) of those states were already included in the composite income tax return category (due to dual filing requirements), so only seven (7) additional states were included in the total of thirty-nine (39) states.

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PETITIONER'S BRIEF

RECORD
AND
BRIEFS

Supreme Court, U.S.
FILED
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No. 13-485

In The Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,

Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

On Writ of Certiorari to the
Court of Appeals of Maryland

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Does the United States Constitution prohibit a state from taxing all the income of its residents—wherever earned—by mandating a credit for taxes paid on income earned in other states?

PARTIES TO THE PROCEEDINGS

The petitioner is the Comptroller of the Treasury of Maryland, Peter Franchot. The respondents are Brian Wynne and Karen Wynne.

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OPINIONS BELOW

The opinion of the Court of Appeals of Maryland is reported at 431 Md. 147. Pet. App. 1-52. The opinion and order of the Circuit Court for Howard County are unreported. Pet. App. 53-129. The order and oral ruling of the Maryland Tax Court also are unreported. Pet. App. 130-41.

JURISDICTION

The Court of Appeals of Maryland issued its decision on January 28, 2013. Pet. App. 1-49. On May 17, 2013, the Court of Appeals issued an opinion clarifying its decision, denying the Comptroller's timely request for rehearing, and staying the effect of the court's judgment pending this Court's disposition of a petition for a writ of certiorari. Pet. App. 50-52. On July 30, 2013, the Chief Justice extended the time for filing the petition to and including October 14, 2013. The petition was filed on October 13, 2013 and was granted on May 27, 2014. This Court's jurisdiction rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution provides:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. . . .

U.S. Const. art. I, § 8, cl. 3.

The Due Process Clause of the Fourteenth Amendment to the United States Constitution provides:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law. . . .

U.S. Const. amend. XIV, § 1.

The Maryland statutory provisions that authorize the personal income taxes and the tax credit at issue in this case are reproduced in the appendix to the petition. Pet. App. 142-44.

STATEMENT

The decision below prevents Maryland from collecting personal income taxes from its own residents to the extent that income has been earned in and taxed by another state. That ruling cannot be squared with the decisions of this Court recognizing "the rule, accepted interstate and internationally, that a sovereign may tax the entire income of its residents." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 453 (1995). The lower court reached its unprecedented conclusion based on an unsound expansion of dormant Commerce Clause jurisprudence, even though the constraints on state authority imposed by that provision were never intended to "protect state residents from their own state taxes." *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989). In its effort to prevent multiple taxation resulting from different states' independent but overlapping taxing jurisdiction, the Court of Appeals mistakenly treated Maryland's entirely neutral tax system as discriminatory and then faulted the State for not properly apportioning a tax

based on a factor—a taxpayer's status as a Maryland resident—that is plainly not susceptible to multi-state apportionment. There is no justification for the court's erroneous decision, and it should not be permitted to stand.

1. Maryland's Individual Income Tax. For Maryland residents, the State personal income tax has two basic components. The first is a "State tax" that is imposed on the "Maryland taxable income of each individual." Md. Code Ann., Tax-General ("Tax-Gen.") § 10-102. The second is a "County tax" that is likewise imposed on the "Maryland taxable income of . . . each resident." Tax-Gen. § 10-103(a)(1). The graduated rates for the "State tax" are the same for all Maryland residents. *See* Tax-Gen. § 10-105(a), (c). The rate of the "County tax" varies from county to county and is imposed according to the Maryland county in which the taxpayer resides. *See generally Frey v. Comptroller*, 422 Md. 111, 125-27 (2011) (describing Maryland income tax scheme for individual taxpayers).[1]

The Maryland tax code defines an individual's "Maryland taxable income" as "Maryland adjusted gross income, less the exemptions and deductions allowed under this title." Tax-Gen. § 10-101(i). It then defines "Maryland adjusted gross income" as "the individual's federal adjusted gross income for the taxable year," a figure that is subject to various

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[1] Because Maryland nonresidents by definition do not reside in a Maryland county, they instead pay, in addition to the State nonresident tax, a special nonresident tax that is set at a rate "equal to the lowest county income tax rate set by any Maryland county." Tax-Gen § 10-106.1.

specified adjustments. Tax-Gen. § 10-203. Finally, the tax code defines "federal adjusted gross income" as "the individual's adjusted gross income as determined under the Internal Revenue Code." Tax-Gen. § 101(e).[2]

The Maryland tax code grants substantial, though not total, tax credits to residents for income taxes paid to other states. In particular, the State provides a full credit against the "State tax," Tax-Gen. § 10-703(a), subject to a qualification that Maryland must receive no less tax than it would receive if it directly taxed the resident taxpayer's Maryland income (as opposed to taxing all of the taxpayer's income and then giving credits), *see* Tax-Gen. § 10-703(c)(1)(ii).[3] Thus, for example, a Maryland resident earning all of her income in other states might pay no Maryland "State tax" at all.

The Maryland tax code does not, however, allow a credit against the "County tax." The statute specifically states that "a resident may claim a credit only against the State income tax for a taxable year . . . for State tax

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[2] Unlike Maryland residents, nonresidents are permitted to reduce their "federal adjusted gross income" by subtracting all income except for certain specified Maryland income, such as "(1) income derived from real or tangible personal property located in the State," and "(2) income derived from . . . (ii) an occupation, profession, or trade that is wholly carried on in the State." Tax-Gen. § 10-210(b). As a consequence, Maryland generally taxes nonresidents only on income earned in Maryland.

[3] This limitation, common among states, *see* W. Hellerstein, *State Taxation* ¶ 20.10[1] (3d ed. 2013), effectively means that, if the income is taxed by the other state at a rate higher than the Maryland State tax, no credit will be allowed for the portion of the tax paid to the other state at the higher rate.

on income paid to another state for the year." Tax-Gen. § 10-703(a). As a result, a Maryland resident earning all of her income in another state would still pay the "County tax," even if she has reduced her "State tax" obligation to zero by taking tax credits for taxes paid to other states.

2. This Litigation. Respondents Brian and Karen Wynne are a married couple with five children who resided in Howard County, Maryland in 2006, the tax year at issue. Pet. App. 8-9. Mr. Wynne held a 2.4% ownership interest in Maxim Healthcare Services, Inc. ("Maxim"), a Maryland Subchapter-S corporation based in Howard County. Pet. App. 9. Maxim provides home healthcare, medical staffing, and other services nationwide. Pet. App. 8-9, 55-56.

On their 2006 joint return, the Wynnes reported taxable net income of approximately $2.7 million, more than one-half of which represented Mr. Wynne's share of the distributions from Maxim's earnings. Pet. App. 56; J.A. 16, 58, 62. The State component of the Maryland tax (the "State tax") on that income, before allowance of any credits, was $126,636. J.A. 19, 75. However, the Wynnes claimed a credit against this component, in the amount of $84,550, for taxes that Maxim had paid to 39 other states on Mr. Wynne's share of the company's income derived from activities in those states.[4] Pet. App. 56; J.A. 19, 75, 84. Neither

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[4] Some of these states recognized Maxim's election to be taxed as an S-corporation and accorded "pass-through" treatment to its income, as the federal government and Maryland do. *See* 26 U.S.C. §§ 1361, 1366; Tax-Gen. §§ 10-102.1(b), 10-104(6). Those states required Maxim to file composite returns on behalf of their owners.

Maxim nor the Wynnes reported having paid income taxes to any county or local government outside Maryland, Pet. App. 9, and the Wynnes did not attempt to claim a credit against the County component of their Maryland taxes for the taxes paid to other states that exceeded the allowable credit against the State component, Pet. App. 56.

The Comptroller determined that the Wynnes had underpaid their 2006 taxes, and issued a deficiency assessment. A hearing officer affirmed the assessment, Pet. App. 10, and the Wynnes appealed to the Maryland Tax Court. Initially, the Wynnes disputed only the Comptroller's calculation of the State component of their income tax liability and did not assert that the State's failure to extend the credit to the County component of the tax violated any State or federal constitutional provision. Pet. App. 10; J.A. 88-93.

Six months later, however, the Wynnes amended their petition to advance a new constitutional claim. Pet. App. 10; J.A. 1. As an alternative to their statutory argument, the Wynnes asserted that the Maryland tax system, as applied by the Comptroller and as construed by Maryland courts, violates the Commerce Clause of the United States Constitution. The Tax Court rejected

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Other states required Maxim to file a corporate tax return instead of or in addition to the composite return filed on behalf of Maxim's shareholders. The Maryland personal income tax credit invoked by the Wynnes allows a credit for a resident's share of the taxes paid by an S-corporation to another state, regardless of whether the state accords pass-through treatment to the entity. *See* Tax-Gen. § 10-703(c)(1), (2).

both arguments and affirmed the assessment. Pet. App. 136, 140.

The Wynnes sought judicial review in the Circuit Court for Howard County. Pet. App. 54-55; J.A. 3, 4. Abandoning their statutory argument entirely, the Wynnes argued that the dormant Commerce Clause requires Maryland to extend the credit for out-of-state tax payments that already applies to the "State tax" by making it applicable to the "County tax" as well. Pet. App. 63. The circuit court agreed, and held that the Maryland tax scheme violates the Commerce Clause because it fails to allow full credits for taxes paid to other states. The court therefore reversed the Tax Court's ruling upholding the deficiency assessment against the Wynnes. Pet. App. 126.

The Comptroller appealed. In response, the Wynnes petitioned the Court of Appeals of Maryland for review before consideration in the intermediate appellate court. The Court of Appeals granted the petition. 424 Md. 291 (2012).

The Court of Appeals then affirmed on the merits. In its view, "the failure of the Maryland income tax law to allow a credit against the county tax for a Maryland resident taxpayer with respect to pass-through income of an S corporation that arises from activities in another state and that is taxed in that state violates the dormant Commerce Clause of the federal Constitution." Pet. App. 32.

In reaching this conclusion, the Court of Appeals first brushed aside the Comptroller's contention that Maryland has a sovereign right to tax all of the Wynnes' income, regardless of where it was earned.

Although the Comptroller had argued that the Wynnes were subject to Maryland's tax "because of their status as Maryland residents and not because of their activities in intrastate or interstate commerce," Pet. App. 15, the court dismissed this contention as "a false dichotomy," Pet. App. 15. Rather, the Court opined, the Wynnes "are subject to the income tax because they are Maryland residents *and* because they have income derived from intrastate and interstate activities." Pet. App. 15 (emphasis in original). The court noted that "other states may also tax some of that same income because it derives from activities in those state[s]," and that, as a result, "this case concerns the constitutional constraint on the otherwise overlapping power to tax such income." Pet. App. 15.

Turning to the credit provision, the Court of Appeals expressed its concern that "[t]he limitation of the credit for payments of out-of-state income taxes to the State portion of the Maryland income tax can result in significantly different treatment for a Maryland resident taxpayer who earns substantial income from out-of-state activities when compared with an otherwise identical taxpayer who earns income entirely from Maryland activities." Pet. App. 16. The court said that, as a result of this "different treatment," Pet. App. 16, "the first taxpayer may pay more in total state and local income taxes than the second," Pet. App. 16. According to the court, "this creates a disincentive for the taxpayer—or the S corporation of which the taxpayer is an owner—to conduct income-generating activities in other states with income taxes." Pet. App. 16.

The court then applied the four-part test from *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 270 (1977), *see* note 13 below (quoting test), and ultimately concluded that the Maryland tax scheme violates the Commerce Clause. The court rested its decision on two separate, though related, grounds. First, it found that the Maryland tax on its residents is not fairly apportioned. Pet. App. 18-27. In reaching this conclusion, the court relied primarily on the "internal consistency" test, a test that had not previously been applied to individual taxes based on residency. Applying the test in this unprecedented fashion, the court determined that, under the terms of the Maryland tax scheme, resident taxpayers earning income in multiple states would pay higher taxes than resident taxpayers with income in only one state. Pet. App. 22 ("[A] taxpayer with income sourced in more than one state will consistently owe more in combined state income taxes than a taxpayer with the same income sourced in just the taxpayer's home state."). While the court recognized that a state tax can fail to pass the internal consistency test and still be constitutional, Pet. App. 23-24 (citing *American Trucking Ass'ns, Inc. v. Michigan Pub. Serv. Comm'n*, 545 U.S. 429 (2005)), the court found no sufficient ground for upholding Maryland's tax on its residents, Pet. App. 23-24.

The court also concluded that Maryland's tax on its residents failed the "external consistency" test. Although the Maryland tax scheme is based on the status of residency, not on any particular income-earning activity in Maryland, the court nonetheless looked to "whether [the] tax reaches beyond that portion of value that is fairly attributable to economic

activity within the taxing state." Pet. App. 26 (quoting *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995)). The court observed that, "[b]ecause no credit is given with respect to the county tax for income earned out-of-state, the Maryland tax code does not apportion income subject to that tax even when that income is derived entirely from out-of-state sources." Pet. App. 26. "Thus, when income sourced to out-of-state activities is subject to the county tax, there is a potential for multiple taxation of the same income." Pet. App. 26.

Finally, the Court of Appeals decided that the Maryland tax scheme discriminates against interstate commerce. Pet. App. 28-32. As it had in its discussion of fair apportionment, the court again focused its analysis on the idea that a Maryland resident might pay more taxes *in total* if the resident earned income in more than one state. The court thus ignored the fact that Maryland treats a resident's income exactly the same regardless of where it is earned. The court explained its finding of discrimination by stating that "[t]he application of the county tax to the out-of-state pass-through income without application of a credit for out-of-state income taxes on the same income means that Maryland shareholders—the Wynnes in this case—may be taxed at a higher rate on income earned through Maxim's out-of-state activities than on income earned though its Maryland activities." Pet. App. 30.

Judges Greene and Battaglia dissented. Rejecting the majority's novel Commerce Clause theory, they concluded that, in the absence of any constitutional violation, the question whether to grant a full credit to residents of Howard County "is an issue for the elected

officials of Howard County and the State, not this Court." Pet. App. 37.

SUMMARY OF ARGUMENT

I. This Court has said on multiple occasions that states have jurisdiction "to tax all income of their residents, including income earned outside their borders." *Chickasaw Nation*, 515 U.S. at 463 n.12; *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 280-81 (1932). Unlike most taxing powers, a state's sovereign authority to tax its residents' income is neither derived from, nor confined by, the state's connection to specific income-producing activities within the state. Rather, "[d]omicil itself affords a basis for such taxation." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937). As a result, a state "can tax the privilege of residence in the State and measure the privilege by net income, including that derived from interstate commerce." *Freeman v. Hewit*, 329 U.S. 249, 255 (1946).

The states' broad taxing power over their residents' income is justified because it corresponds to the extraordinary benefits that states grant to those residents. In addition to protection of the residents' right to receive and enjoy their income, *see Lawrence*, 286 U.S. at 281, a state provides its residents with significant financial subsidies that it does not grant to persons living outside its borders. For example, Maryland and its local governments spend more than $11 billion each year to educate children who attend Maryland public schools. Last year alone, Maryland paid more than $4 billion for healthcare and related services for Maryland residents in carrying out its obligations under the federal Medicaid program, the Children's Health Program, and related services.

Sensibly enough, Maryland has designed its income tax system to assure that all Maryland residents contribute at least some income taxes to the funding of these far-reaching benefits. To accomplish that purpose, Maryland first taxes the entire net income of its residents but then, by allowing a credit against the Maryland "State tax," grants residents a substantial (though not total) credit for taxes paid to other states. This two-step system strikes a considered balance between privilege and responsibility, by substantially reducing Maryland tax payments for residents earning income outside Maryland, while still requiring those residents to pay some income tax to support State and local government programs. The decision of the Court of Appeals, however, would significantly alter that bargain. By compelling Maryland to give a full credit for tax payments to other states—that is, a credit that could be applied against the County tax as well as the State tax—the lower court's ruling would have the perverse effect of allowing certain taxpayers to enjoy all the benefits available to Maryland residents without contributing any income taxes in return.

The Court of Appeals' imposition of this one-sided arrangement is particularly unjustified, given the ability of Maryland residents to exercise their political power to change unpopular tax policies. In contrast to many state tax schemes invalidated by this Court, the tax system challenged here does not impose disproportionate burdens on nonresidents who have no political recourse in the taxing state. To the contrary, Maryland's system simply asks something more of the State's own citizens, "the insider[s] who presumably [are] able to complain about and change the tax

through [the State's] political process." *Goldberg*, 488 U.S. at 266.

II. A. Despite paying lip service to the principle that a state of residence may tax all the income of its residents, Pet. App. 3-4, the Maryland Court of Appeals rendered that principle largely meaningless by holding that the State is effectively barred from taxing its residents' out-of-state income to the extent that another state has already taxed that income. That contradictory rule is insupportable. If a state has jurisdiction to tax all its residents' income—as it does—nothing in the Constitution compels the state to subordinate its exercise of that lawful authority to the taxing authority of other states.

In reaching a contrary conclusion, the Court of Appeals was plainly motivated by a concern about exposing taxpayers to multiple taxation by different states. But the court failed to recognize that multiple taxation, while it may sometimes be the consequence of an unconstitutional tax, can also arise in situations where multiple jurisdictions have exercised their taxing powers within permissible limits. In many cases, of course, the existence of multiple taxation is a powerful signal that at least one state is exceeding its lawful taxing jurisdiction, and, in those circumstances, it is appropriate for courts to eliminate the multiple taxation by invalidating the overreaching tax. But this case involves a quite different scenario, one in which all of the taxing states are acting within the scope of their legitimate taxing authority. In that type of situation, this Court has made clear that each sovereign is free to impose its tax, even if multiple taxation occurs. *See, e.g., State Tax Comm'n of Utah v. Aldrich*, 316 U.S.

174, 181 (1942) ("[T]here is no constitutional rule of immunity from taxation of intangibles by more than one State.").

The constitutional respect for independent taxing authority, even in the face of multiple taxation, reflects several well-established principles. To begin with, it properly recognizes that different states may provide benefits to a taxpayer for which each of those states can ask a fair return. *See Curry v. McCanless*, 307 U.S. 357, 368 (1939). At the same time, as applied to taxes based on residency, it also honors the states' broad taxing jurisdiction over their residents' income, thereby giving necessary force to the understanding that states do significantly more for their residents than they do for taxpayers who simply earn income within their territory.

The rule granting latitude for multiple taxation also eliminates the insurmountable problem of deciding which of two (or more) lawful state taxes should be given priority. The Constitution does not provide an answer to that question, or even suggest what factors might reasonably be regarded as determinative. That silence is hardly surprising: it is highly unlikely that, in giving assent to the federal Constitution, the states were authorizing courts to align the states in some judicially created taxing queue, even when they act within the bounds of their proper taxing jurisdiction.

B. The Court of Appeals justified its decision on the ground that the Maryland tax system violates the negative Commerce Clause, but the court's Commerce Clause analysis was off-base in several critical respects. First of all, in arriving at its conclusion that Maryland's tax system discriminates against interstate

commerce, the court simply conducted the wrong inquiry, by looking at the taxes that the Wynnes paid (and that Maxim paid directly or on behalf of the Wynnes) to all states *in total*, rather than the taxes paid to Maryland alone. Under the correct inquiry, it is plain that Maryland's resident income tax system is completely neutral with respect to interstate commerce and makes no distinction at all between income earned in Maryland and income earned in other states. *See Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) ("[A] law [is] discriminatory if it taxes a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." (internal quotation marks and alterations omitted)). The higher *overall* tax burden is no more than the "accidental incident of interstate commerce being subject to two different taxing jurisdictions." *Jefferson Lines*, 514 U.S. at 192 (internal quotation marks omitted).

The Court of Appeals was also wrong to find that Maryland's tax is not fairly apportioned. The Maryland tax is based on the taxpayer's status, as a Maryland resident, and, by definition, only one state can impose a valid tax based on residency within its borders. The object of taxation, residency status, is unlike the income of a unitary business, because there is no need for it to be apportioned among various taxing states in order to assure that each state is taxing only its rightful share. For the same reason, by resorting to the internal consistency test, which is useful primarily as a method for evaluating the neutrality of a particular apportionment formula, the Court of Appeals allowed itself to become distracted by an analysis that is simply beside the point in a context where no apportionment is required in the first place.

The Court of Appeals made a similar mistake in concluding that Maryland's tax is not externally consistent. The external consistency inquiry asks "whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines*, 514 U.S. at 185. But a state tax based on residency is not intended to be a tax on "economic activity within the taxing state." Rather, it is a tax "on the privilege of residence in the State," *Freeman*, 329 U.S. at 255, and, as this Court has explicitly said, the state may "measure the privilege by net income, including that derived from interstate commerce." *Id.*

Finally, the Maryland resident income tax manifestly does not implicate the kind of "economic protectionism" that is the central concern of the negative Commerce Clause. *See, e.g., Department of Revenue v. Davis*, 553 U.S. 328, 337-38 (2008). The clear purpose of Maryland's decision to provide partial credits was to make sure that all Maryland residents provide some income tax support for governmental programs, and there is no indication whatsoever that the tax scheme has actually deterred Maryland residents from earning income in other states. Moreover, if Maryland residents are displeased with their taxes, they not only have the political capacity, as eligible Maryland voters, to press for changes to the State's tax laws, but they can also appeal to Congress, which is expressly empowered to address any genuine threats to interstate commerce and which, as a legislative body, is better suited than the judiciary to undertake that task.

ARGUMENT

For nearly a century, this Court has recognized that states have jurisdiction "to tax all income of their residents, including income earned outside their borders." *Chickasaw Nation*, 515 U.S. at 463 n.12; *New York ex rel. Cohn*, 300 U.S. at 313; *Lawrence*, 286 U.S. at 281. This broad taxing authority—which extends beyond a sovereign's usual power to tax property or activities within its territory—rests on two fundamental understandings: first, that a state provides unique benefits to its residents that are not shared by nonresidents; and, second, that residents have the political capacity to redress unwanted taxation at the ballot box.

The decision below takes no account of these fundamental attributes of a sovereign's relation to its own residents. By requiring Maryland to grant a full credit for income taxes paid to other states—that is, to extend the existing credit so that it can be used to offset a resident's County income tax obligation as well as the State income tax—the lower court's ruling wrongly demands that Maryland yield in the exercise of its taxing power to other sovereigns, even though Maryland provides extensive benefits (free public schooling, public assistance, etc.) that those other sovereigns do not provide to Maryland residents. To make matters worse, in creating this judicially imposed rule of deference to other states, the Court of Appeals incorrectly imported constitutional rules restricting multiple taxation into a domain where those restrictions do not apply—that is, where each state is exercising an independent, and wholly legitimate, basis for imposing its tax. Nothing in the Constitution

justifies this sharp curtailment of Maryland's taxing powers, and the decision below should be reversed.

I. A State Has Jurisdiction to Tax All the Income of its Residents, Even If That Income Is Earned in Other States.

A. A State Has Broad Taxing Authority over its Residents.

This Court has repeatedly acknowledged the "well-established principle of interstate and international taxation—namely, that a jurisdiction, such as [a state], may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Chickasaw Nation*, 515 U.S. at 462-63 (emphasis in original); *see also Aldrich*, 316 U.S. at 179; *Curry*, 307 U.S. at 368; *Guaranty Trust Co. of New York v. Virginia*, 305 U.S. 19, 23 (1938); *New York ex rel. Cohn*, 300 U.S. at 313; *Lawrence*, 286 U.S. at 281; *Maguire v. Trefry*, 253 U.S. 12, 17 (1920); *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). As the Court long ago observed, "[i]t is enough, so far as the constitutional power of the state to levy it is concerned, that the tax is imposed by [the state] on its own citizens with reference to the receipt and enjoyment of income derived from the conduct of business, *regardless of the place where it is carried on*." *Lawrence*, 286 U.S. at 280-81 (emphasis added).

A state's authority to tax its residents' income has been given broad scope because it arises from the state's relationship with the *person* who "recei[ves] and enjoy[s]" the income, *id.* at 281, rather than being dependent on the state's connection to particular income-producing activities within its territory. As this Court has explained, "[d]omicil itself affords a basis for

such taxation." *New York ex rel. Cohn*, 300 U.S. at 313.[5] "The tax . . . is founded upon the protection afforded to the recipient of the income by the state, in his person, in his right to receive the income, and in his enjoyment of it when received." *Lawrence*, 286 U.S. at 281. "These are rights and privileges incident to [the taxpayer's] domicile in the state, and . . . the economic interest realized by the receipt of income or represented by the power to control it, bears a direct legal relationship" to those rights and privileges of residence. *Id.*; *accord New York ex rel. Cohn*, 300 U.S. at 313.

It is precisely because domicile furnishes an independent ground for taxation that a state's taxing authority with respect to its own residents is undiminished by the fact that a resident's income may have been earned from sources or activities beyond that state's boundaries. This Court has made clear that "[n]either the privilege nor the burden" associated with residency "is affected by the character of the source from which the income is derived." *New York ex rel. Cohn*, 300 U.S. at 313. Thus, "[a] state may tax its residents upon net income from a business whose physical assets, located wholly without the state, are beyond its taxing power." *Id.* Likewise, a state "can tax the privilege of residence in the State and measure the privilege by net income, including that derived from interstate commerce." *Freeman*, 329 U.S. at 255.

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[5] For purposes of taxes on individuals, this Court has generally regarded the terms "residence" and "domicile" (or "domicil") as interchangeable. *See, e.g., New York ex rel. Cohn*, 300 U.S. at 313 (referring without distinction to "domicil" and "privileges of residence").

B. A State Has Special Obligations to its Residents.

A state's broad taxing power over its residents' income is a natural counterpart to the special obligations that states assume with respect to those residents. As this Court has explained, "[e]njoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from responsibility for sharing the costs of government." *Lawrence*, 286 U.S. at 279. More specifically, "[t]he obligation of one domiciled within a state to pay taxes there[] arises from unilateral action of the state government in the exercise of the most plenary of sovereign powers, that to raise revenue to defray the expenses of government *and to distribute its burdens equitably among those who enjoy its benefits*." *Id.* (emphasis added).

The obligations of states to their residents have only grown, both in kind and in degree, with changes in the role of state governments. Today, it is common for states to provide their residents with a host of financial benefits that are unavailable to nonresidents. For example, only Maryland residents are entitled to attend Maryland's public schools, *see* Md. Code Ann., Educ. § 7-101(b); are qualified for preferential admission and reduced tuition at Maryland public universities and colleges, *see Frankel v. Board of Regents*, 361 Md. 298, 302-03 (2000); Univ. Sys. of Md. Policy III-4.0; are eligible for a broad array of public-assistance programs, *see, e.g.*, Code Md. Regs. 07.03.07.03(A)(1), 07.03.17.08(A)(2), 07.03.21.03(A)(1); and can obtain health benefits under the State's expanded Medicaid program, *see* Code Md. Regs.

10.09.24.05-3(A). In comparison, Maryland residents have no right to demand similar benefits from states where they may earn income but do not reside.

The cost of these state programs benefiting Maryland residents is substantial. With respect to education, in Fiscal Year 2012, the State expended approximately $5.75 billion, and local governments spent nearly as much, $5.44 billion, to fund public schools serving Maryland children. *See* Maryland State Department of Education, *The Fact Book 2012-2013*, at 21.[6] In addition, nearly a quarter of a million Maryland residents attended Maryland public institutions of higher education last year alone. *See* Maryland Higher Education Commission, *Report on Enrollment by Place of Residence* (May 2014), at 60-61.[7] Those students benefit from significantly reduced tuition rates; undergraduate tuition at the University of Maryland at College Park, for example, is more than $20,000 lower for residents than for nonresidents. *See Higher Education—Fiscal 2015 Budget Overview*, at 12.[8] Maryland will spend more than $1.8 billion on its

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[6] Available at http://www.marylandpublicschools.org/MSDE/divisions/bus_svcs/fb.htm.

[7] Available at http://www.mhec.state.md.us/publications/research/index.asp.

[8] Available at http://mgaleg.maryland.gov/pubs/budgetfiscal/2015fy-budget-docs-operating-HIGHED-Higher-Education-Overview.pdf.

higher education system in the current fiscal year. *See id.* at 2.[9]

Maryland also expends substantial sums on social service programs related to health and welfare for low-income residents. Last year, the State spent more than $4 billion in State general and special funds (exclusive of federal matching funds) on the State's Medicaid program, the State's Children's Health Program, and other programs to pay for needed medical and habilitative services for Maryland residents. *See* Maryland Department of Budget and Management, *FY 2015 Budget Book*, Vol. II, pp. 186, 216, 233, 251.[10] Each month, a quarter of a million needy Maryland residents benefit from the State's food supplement program, at an annual cost in excess of $1.1 billion. *See* Maryland Department of Human Resources, *Family Investment Administration 2014 Statistical Report*.[11] Approximately 45,000 Maryland children receive benefits each month under Maryland's Temporary Cash Assistance Program (the State's program implementing the federal Temporary Assistance to

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[9] Local governments in Maryland also make substantial expenditures to fund institutions of higher education. Howard County, for instance, will spend more than $31 million for this purpose in its current budget. *See* Howard County, *Fiscal Year 2015 Approved Operating Budget Detail*, at 53 (available at http://www.howardcountymd.gov/current_budget.htm.

[10] Available at http://www.dbm.maryland.gov/agencies/operbudget/Documents/2015/Proposed/hlthhosp.pdf.

[11] Available at http://www.dhr.state.md.us/documents/Data%20and%20Reports/FIA/Statistical%20Reports/Statistical-Reports-2014.pdf.

Needy Families program), at an annual cost of $144 million. *See id.*

It is not too much to ask, then, for Maryland residents to contribute more to the support of these State programs than is asked from nonresidents who merely earn income in Maryland and who do not benefit to the same extent from the programs and services provided by the State and its local governments. As the Court has explained, "[a] tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits." *New York ex rel. Cohn*, 300 U.S. at 313. Here, Maryland has chosen to steer a middle course. Under the Maryland tax structure, the State first exercises its constitutional authority to tax all the income of its residents, but it then provides credits against the Maryland "State tax" for income taxes paid to other states. As a result, a Maryland taxpayer earning income elsewhere routinely pays much less tax to Maryland than a Maryland taxpayer earning all of her income in Maryland. By declining to grant a credit against the "County tax" as well, the State assures that all resident taxpayers nevertheless contribute at least *some* income tax to fund the government programs from which they benefit.

The decision below would work radical changes to that rational compromise. Under the Court of Appeals' theory, a Maryland resident earning all of her income in other states might well have no obligation to pay any Maryland income tax at all—neither the "State tax" nor the "County tax"—with the full amount of her income taxes instead being remitted to states in which the

income was earned. Yet, despite that lack of contribution to the Maryland treasury, this resident whose income had thus been exempted from taxation in Maryland would still be entitled to claim all the advantages of residence, by sending her children to Maryland public schools or applying for various forms of public assistance that are reserved for Maryland residents. *See Comptroller v. Blanton*, 390 Md. 528, 536 n.9 (2006) (noting "possible absurd result of the [taxpayers] paying little or no local tax for services provided by the county while a neighbor with similar income, exemptions, and deductions might be paying a substantial local tax to support those services" (internal quotation marks omitted)). That all-take-and-no-give arrangement is antithetical to the traditional expectation that state residents will bear heightened responsibilities in return for the privileges associated with residence. It is hard to discern the justification for imposing a constitutional requirement that would compel states to accommodate residents who prefer to accept the benefits of residency while avoiding the corresponding responsibilities.

C. State Residents Have the Political Capacity to Change Tax Policy.

Any asserted justification for imposing this sort of constitutional mandate is even more questionable in light of a second distinctive feature of the relationship between states and their residents: the power of state residents to eliminate unpopular taxes through political means. If Maryland residents think that the State is taxing them too onerously, they can give direct effect to their views by voting for various forms of lower taxes, including more generous credits for out-of-state

tax payments. After all, state legislators are hardly impervious to voters' opinions about high taxes. Almost two centuries ago, this Court pointedly remarked that, "[i]n imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation." *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 428 (1819).[12]

Residents aggrieved by their own state's taxes thus are situated differently from nonresidents with no effective voice in legislative decisions. As this Court has observed, when a state law "is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation where it affects adversely some interests within the state." *South-Central Timber Dev. Inv. v. Wunnicke*, 467 U.S. 82, 92 (1984). But the opposite is true here. The Maryland residency tax is, on its face and in operation, a tax on Maryland's own citizens, "the insider[s] who presumably [are] able to complain about and change the tax through [the State's] political process." *Goldberg*, 488 U.S. at 266. The court below thus not only misapplied an important body of constitutional law, but needlessly imposed a judicial solution to what is, at most, a political problem.

For their part, the Wynnes have suggested that, instead of giving only partial credits for out-of-state income taxes, Maryland should give full credits and

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[12] Individual residents differ in this respect from domiciliary corporations, which do not possess the capacity to affect change by voting (and are typically eligible for far fewer across-the-board public assistance programs).

then raise other taxes (for example, local property taxes) to replace the lost revenue. *See* Br. in Opp. 23. But that kind of revision would do nothing to address the prospect that some resident taxpayers would receive a free ride insofar as Maryland income taxes are concerned. Furthermore, the best way for Maryland to raise revenue from its residents is a classic matter for legislative judgment. As this Court has said, "[b]ecause state legislatures must draw some distinctions in light of 'local needs,' they have considerable discretion in formulating tax policy." *Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287, 297 (1998); *see also Madden v. Kentucky*, 309 U.S. 83, 88 (1940) (acknowledging "the large area of discretion which is needed by a legislature in formulating sound tax policies"). Thus, questions about the appropriate structure of Maryland's tax system should be left to Maryland officials and their constituents, unless that democratically established system offends some overriding constitutional principle. The Constitution contains no such command for altering the tax scheme designed by Maryland's elected representatives.

II. The Constitution Does Not Require a State to Subordinate its Own Legitimate Taxing Authority to the Taxing Authority of Other States.

The Court of Appeals acknowledged that Maryland has jurisdiction to tax all its residents' income. *See* Pet. App. 12. But the court's decision rendered that principle a virtual nullity by requiring Maryland to give credits against both State and County taxes for income taxes that residents have paid to other states.

According to the Court of Appeals, if multiple taxation would otherwise result, the Commerce Clause compels a state of residence to forgo its taxes on out-of-state income in favor of states where the income was earned. Nothing in the court's opinion supports that unprecedented holding. The Constitution contains no such rule of enforced priority, and the Court of Appeals' attempt to invent one should be rejected.

A. The Constitution Does Not Impose an Absolute Prohibition on Multiple Taxation.

To start with, it is noteworthy that the mandatory-credit rule announced by the Court of Appeals is directly at odds with the view recently expressed by this Court in *Chickasaw Nation*. There, this Court reaffirmed that "sovereigns have authority to tax all income of their residents, including income earned outside their borders. . . ." 515 U.S. at 463 n.12. But the Court's discussion of sovereign taxing power did not end there. Having pointed out that sovereigns "sometimes elect not to do so [that is, tax all their residents' income], and [that] they commonly credit income taxes paid to other sovereigns," the Court stated unequivocally: "'If foreign income of a domiciliary taxpayer is exempted, this is an independent policy decision and *not one compelled by jurisdictional considerations*.'" *Id.* (quoting American Law Institute, *Federal Income Tax Project: International Aspects of United States Income Taxation* 6 (1987)) (emphasis added). These observations convey the Court's appreciation of a sovereign's broad taxing power that the decision below necessarily repudiates.

Even if one were inclined to dismiss those observations as irrelevant, as the Wynnes have urged,

see Br. in Opp. at 15; Supp. Br. in Opp. at 9, the decision below, when examined on its own merits, is ill-founded. Although the Court of Appeals ultimately invalidated Maryland's tax scheme based on a multi-part Commerce Clause analysis, the court's ruling was plainly driven by an assumption that taxpayers should be sheltered from multiple taxation. Pet. App. 4, 15, 16, 18, 22, 26, 30. The problem with that assumption is that multiple taxation is not always unconstitutional. To be sure, multiple taxation will often arise out of a state's attempt to exceed its valid taxing jurisdiction, and, in those circumstances, the Constitution does protect taxpayers from multiple taxation, by invalidating the unlawful tax. *See Jefferson Lines*, 514 U.S. at 184-85 (prohibited "multiple taxation . . . is threatened whenever one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it"). Still, in other, quite different, situations, the various taxing states are all acting within the bounds of their legitimate taxing powers, and in those situations, the Constitution permits each state to levy its own tax without giving way to the other states, multiple taxation notwithstanding.

This Court could hardly have made that principle any clearer. For example, in rejecting an argument that a state of residence could not tax intangibles physically held in (and taxed by) another state, the Court instructed: "[I]t is undeniable that the state of domicile is not deprived, by the taxpayer's activities elsewhere, of its constitutional jurisdiction to tax, and consequently that there are many circumstances in

which more than one state may have jurisdiction to impose a tax and measure it by some or all of the taxpayer's intangibles." *Curry*, 307 U.S. at 368. Elaborating on the same principle in *Curry*, the Court declared, unambiguously, that "income may be taxed *both* by the state where it is earned *and* by the state of the recipient's domicile," *id.* (emphasis added); this is so, the Court explained, because "[p]rotection, benefit, and power over the subject matter are not confined to either state," *id.*

The Court had emphasized the same point just the year before in *Guaranty Trust*. There, the Court expressly permitted overlapping taxation of income where one state was taxing on the basis of residency and a second state was taxing on the basis of situs. *See* 305 U.S. at 21 (noting that New York had taxed income of a New York trust and that Virginia had taxed income from the trust received by a Virginia resident). In explaining its decision, the Court stated: "Here, the thing taxed was receipt of income within Virginia by a citizen residing there. The mere fact that another state lawfully taxed funds from which the payments were made did not necessarily destroy Virginia's right to tax something done within her borders." 305 U.S. at 23.

To make the constitutional rule even more certain, the Court subsequently overruled a number of prior decisions that had "read into the Fourteenth Amendment a rule of immunity from taxation by more than one state." *Aldrich*, 316 U.S. at 176 (internal quotation marks omitted). Reviewing the relevant precedent, the Court found no absolute bar to multiple taxation by separate sovereigns, and pronounced that "the rule of immunity against double taxation espoused

by [those cases] had long been rejected in other cases." *Id.* at 179. The Court thus "repeat[ed]" what it had already said in *Curry*: "[T]here is no constitutional rule of immunity from taxation of intangibles by more than one State." *Id.* at 181.

This judicial respect for the taxing authority of independent sovereigns reflects several familiar principles. As applied to overlapping taxes based on residence and source of income, for example, the doctrine fully accounts for the fact that all of the taxing states have conferred benefits on the taxpayer for which the states can justifiably ask something in return. *See Curry*, 307 U.S. at 368. At the same time, this doctrine remains faithful to the fundamental proposition, established in *Lawrence* and a number of other cases, that a state can tax its residents' entire income, even if some or all of it is earned in other states. Taking the two points together, therefore, the constitutional acceptance of dual taxing authority fits closely with the historical understanding that, even though taxpayers may enjoy benefits conferred by more than one state, residents receive special privileges from, and thus have special obligations to, their home states.

Equally important, the acknowledgement that sovereigns may independently exercise their valid taxing powers resolves—or, more precisely, eliminates—the otherwise intractable problem of deciding which of two legitimate state taxes should take precedence over the other. Nothing in the Due Process Clause or the Commerce Clause provides tools for answering that question. The Constitution contains no hierarchy of taxing jurisdictions, no provision

specifying that a state in which a taxpayer earns income has greater taxing authority than a state in which the taxpayer resides, and no provision establishing that the opposite is true. Absent any constitutional basis for such ranking, the courts may not invalidate a perfectly constitutional state tax just to prevent multiple taxation. *See Aldrich*, 316 U.S. at 181 ("It would violate the first principles of constitutional adjudication to strike down state legislation on the basis of our individual views as to policy, whether the state laws deal with taxes or any other subjects of social or economic legislation.").

This case provides a ready illustration of the which-state-gets-priority dilemma. If Maryland, as the state of residence, may constitutionally tax all of its residents' income, it is far from obvious why, in the event of overlapping taxation, the *Maryland* tax must give way in favor of taxes paid to other states. Were the question to be resolved by some sort of balancing test, it would be clear that Maryland provides far more benefits to its residents than the states where they merely go to work. And multiple taxation could be avoided just as readily, of course, if the Court of Appeals' new rule of primacy were simply reversed, obligating states that tax nonresidents on income earned in those states to provide credits for taxes paid to the state of residence.

The Court of Appeals' impulse to eradicate multiple taxation even when it results from concededly valid, but overlapping, exercises of state taxing power creates a conundrum involving the prospect of asymmetrical state taxing power. If, as the court's analysis suggests, the core constitutional problem is multiple taxation,

then overlapping taxing authority presumably is unobjectionable in situations where one state simply refrains from exercising its authority. If so, then Maryland *could* tax its residents on income from another state so long as the other state did not tax that income. The validity of Maryland's tax would turn on policy choices made by the other state. But the taxing powers of a sovereign state do not just vanish and reappear according to how other states choose to tax. Indeed, a theory making a state's power to raise essential revenues contingent on the taxing choices made by other states would severely diminish one of the core attributes of sovereignty, thereby putting the viability of state programs in serious jeopardy.

B. The Commerce Clause Does Not Invalidate Maryland's Tax System.

In the absence of a universal principle barring multiple taxation, the Court of Appeals essentially fashioned one of its own, assembling it from parts drawn from negative Commerce Clause jurisprudence. Applying the four-part test set forth in *Complete Auto Transit*,[13] the court concluded that Maryland could not tax its residents on all of their income (at least if it was taxed by another state) for two related reasons: first, because the Maryland tax scheme discriminates against interstate commerce and, second, because the

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[13] Under that test, a state tax does not offend the Commerce Clause if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the State." 430 U.S. at 279. The Wynnes concede that Maryland's tax scheme satisfies the first and last parts of the test. *See* Pet. App. 17-18 (noting respondents' concession).

Maryland tax is not fairly apportioned. But, even assuming that the *Complete Auto* framework applies to individual income taxes based on state residency—hardly a self-evident proposition—the court's analysis was wrong on both counts.

1. Discrimination. The Maryland tax scheme challenged here does not exhibit any of the features that this Court has found to constitute discrimination under the dormant Commerce Clause. "States are barred from discriminating against foreign enterprises competing with local businesses," *Jefferson Lines*, 514 U.S. at 197, and this Court accordingly has routinely struck down state tax laws on that ground, *see, e.g.*, *South Central Bell Tel. Co. v. Alabama*, 526 U.S. 160, 169-70 (1999) (invalidating franchise tax favoring local corporations over out-of-state corporations); *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278-80 (1988) (invalidating tax credit for all in-state ethanol producers but only some out-of-state producers); *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 883 (1985) (invalidating statute imposing lower tax rate on domestic insurance companies than on out-of-state insurance companies). But there is no disfavoring of out-of-state taxpayers here. Nonresidents are taxed in Maryland only insofar as their income is earned from sources or activities in Maryland. *See* Tax-Gen. § 10-210. That is an unbiased, and entirely permissible, method of assuring that out-of-state individuals and businesses contribute to the operation of Maryland's government. *See Oregon Waste Sys. v. Department of Envtl. Quality*, 511 U.S. 93, 102 (1994) (noting "settled principle that interstate commerce may be made to pay its way").

The Court of Appeals rested its decision on a determination that Maryland discriminates not against out-of-staters, but against interstate commerce itself, on the ground that some Maryland residents will pay more taxes if they do business in other states than if they confine their income-producing activities to Maryland. *See* Pet. App. 16 (referring to "different treatment for a Maryland resident taxpayer who earns substantial income from out-of-state activities"). But, by focusing on the *combined* taxes paid by a Maryland resident—that is, the cumulative taxes paid to all states—the court was conducting the wrong inquiry. No one disputes that Maryland residents may pay greater taxes overall if they do business in other states, but that cumulative burden cannot possibly be attributed to discrimination by Maryland. Rather, it is a natural consequence of the fact that, in our political system, taxpayers are sometimes subject to the taxing authority of distinct sovereigns, each of which has a constitutionally sufficient basis for levying a tax on persons or activities within its borders. As the Court remarked in *Jefferson Lines*, "[t]he multiple taxation placed upon interstate commerce by such a confluence of taxes is not a structural evil that flows from either tax individually, but it is rather the accidental incident of interstate commerce being subject to two different taxing jurisdictions." 514 U.S. at 192 (internal quotation marks omitted); *see also American Trucking Ass'ns*, 545 U.S. at 438 (taxpayer paid higher overall taxes to various states "only because it engages in local business in all those States"); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 279 (1978) (finding no "discriminat[ion] against interstate commerce" where higher taxes were "the consequence of the combined effect" of two different states' statutes).

In undertaking its discrimination inquiry, therefore, the Court of Appeals should have asked a quite different question: whether the Maryland tax scheme *itself* is discriminatory. The obvious answer is no. *See Fulton Corp.*, 516 U.S. at 331 ("[A] law [is] discriminatory if it taxes a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." (internal quotation marks and alterations omitted)); *see also United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 530 U.S. 330, 338 (2007); *Oregon Waste Sys.*, 511 U.S. at 99. As its provisions clearly demonstrate, the Maryland income tax system is structured so that residents are taxed evenhandedly on all of their income, regardless of its origin. Thus, in defining a resident's income for purposes of its tax, Maryland is strictly neutral with respect to whether that income was generated through intrastate or interstate activities.

As support for its finding of discrimination, the Court of Appeals relied on a handful of cases from this Court that struck down state taxes disadvantaging interstate commerce. *See Fulton Corp.*, 516 U.S. at 330, 346; *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 73-75 (1963); *Camps Newfound / Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 575-82 (1997). Those decisions actually serve to highlight the problem with the Court of Appeals' approach. In each of the cited cases, the critical fact demonstrating discrimination was that certain taxpayers might pay less tax *to the taxing state*, precisely because that state's tax scheme openly favored in-state commerce. Thus, in *Fulton Corp.*, North Carolina taxpayers were entitled to pay a reduced intangible tax on their

ownership of corporate stock to the extent that the corporation conducted business in North Carolina. *See* 516 U.S. at 327-28. In *Halliburton*, Louisiana taxpayers liable for a use tax on certain equipment received a tax break if the equipment was assembled in Louisiana rather than out of state. *See* 373 U.S. at 67. And, in *Camps Newfound*, Maine granted favored tax treatment to charitable institutions that primarily served Maine residents, rather than residents from other states. *See* 520 U.S. at 568-69. Here, by contrast, Maryland gives its residents no preference whatsoever for conducting in-state activities: they are subject to tax on all their income, wherever it is earned, and the available credits have the opposite effect of lowering Maryland taxes for those residents who earn income out of state.

The absence of preferential treatment of this sort distinguishes a wide variety of other Commerce Clause cases as well. *See, e.g., Associated Indus. of Missouri v. Lohman*, 511 U.S. 641, 654 (1994) (invalidating use tax for storage of goods purchased out of state insofar as it exceeded sales tax on goods purchased in state); *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 248 (1987) (invalidating exemption from manufacturing tax for manufacturers selling in state); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276 (1984) (invalidating tax exemption for certain locally produced alcoholic beverages); *Armco, Inc. v. Hardesty*, 467 U.S. 638, 641-44 (1984) (invalidating tax exemption granted to local manufacturers). In all of those cases, the Court struck down state tax provisions that lowered that state's taxes for taxpayers conducting in-state activities, while denying the same opportunity to taxpayers engaged in interstate commerce. The non-

discrimination principle applied in those cases cannot be turned upside-down to invalidate tax provisions that, insofar as the taxing jurisdiction is concerned, actually give an advantage to taxpayers with income from interstate business activities. That is simply not actionable discrimination within the meaning of the Commerce Clause.[14]

2. Fair Apportionment. The Court of Appeals' fair apportionment analysis was equally misconceived, albeit for a different reason. In asking whether Maryland was taxing its proper share of the Wynnes' income, the court simply assumed that an individual tax based on residency had to be apportioned among different states. But there are no grounds for that assumption. When a state bases its taxing jurisdiction on an individual's residency, the state is necessarily taxing a status—being a resident—that no other state has jurisdiction to tax. As a result, the question of fair apportionment among competing states simply does not arise. *See generally Tyler Pipe*, 483 U.S. at 251 (upholding unapportioned state wholesale tax because "the activity of wholesaling . . . must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax").

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[14] Maryland will receive fewer tax revenues if a resident earns income in other states, but that is the inevitable consequence of the tax *credit*, not the *tax*. The Court of Appeals did not hold that the Maryland tax credit violates the Commerce Clause, nor could it coherently have done so. Insofar as taxes paid to Maryland are concerned (the proper inquiry), the Maryland tax system plainly *favors* taxpayers with income derived from sources in other states; this type of preferential treatment is the complete opposite of the kind of favoritism the Commerce Clause condemns.

That should be the end of the matter. But, even if Maryland's tax on its residents' income were subject to fair apportionment analysis, the Maryland tax scheme satisfies any reasonable definition of fairness. A state's jurisdiction to tax residents' out-of-state income is grounded in the fact that the state grants its residents numerous opportunities and benefits that no other state provides to them. Here, while Maryland does ask that all of its residents pay some income taxes by way of support, the State ultimately takes only a minority share of any overlapping income taxes and voluntarily gives other states priority (through the allowed credits) for considerably more than one-half of the overlapping amount. Thus, if both sides of the equation are taken into account, Maryland cannot be said to have taken more than its fair share of the overall income taxes that its residents must pay.

The Court of Appeals concluded that Maryland's income tax is not fairly apportioned primarily because the court believed that the tax is not "internally consistent." But this Court has never applied the internal consistency test to a state tax based on an individual's residency, and, at least with respect to the type of claim asserted here, it would make little sense to do so. When different states are asserting jurisdiction over part of an indivisible whole (for example, the total income of a unitary multistate enterprise or the enterprise value of a railroad's rolling stock), the internal consistency test provides a workable method for determining whether a state's apportionment formula assigns it a disproportionate share. *See, e.g., Shell Oil Co. v. Iowa Dep't of Revenue*, 488 U.S. 19, 31 (1988) ("This Court has repeatedly emphasized that the function of an apportionment

formula is to determine the portion of a unitary business' income that can be fairly attributed to in-state activities."); *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 219 (1980); *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 446 (1980). That kind of inquiry has no role to play in the present context, where Maryland's taxing authority rests on one kind of lawful jurisdiction (namely, jurisdiction over the taxpayers as Maryland residents), and the taxing authority of other states rests on a different kind of lawful jurisdiction (namely, jurisdiction over the taxpayers' income-producing activity within those states' borders).[15]

The Court of Appeals' analysis of "external consistency" suffers from a similar flaw. As the court noted, the external consistency inquiry looks to "'whether a state's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing state.'" Pet. App. 26 (quoting *Jefferson Lines*, 514 U.S. at 185). But a state tax based on residence is not—and does not purport to be—a tax on "economic activity within the taxing state." Rather, it is a tax on "the privilege of residence in the State." *Freeman*, 329 U.S. at 255. Thus, assuming that the taxpayer is in fact a resident, *see* note 15 above, the state need not limit its tax to in-state economic activity but may "measure the privilege by net income,

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[15] A state tax based on residency might be subject to internal consistency analysis if the state applied the tax so that it had an impact on taxpayers who actually lived in other states. There is no such claim of inconsistency here. The Wynnes are unquestionably Maryland residents, and Maryland has based its authority to tax them on th basis of their status as residents.

including that derived from interstate commerce." *Id.*; *see generally Curry*, 307 U.S. at 366 ("A jurisdiction which does not depend on physical presence within the state is not lost by declaring that it is absent.").

3. Economic Protectionism. For the reasons discussed above, the Court of Appeals' decision falls short on its own terms. But the real problem with the court's analysis is that the court was trying to pound a square peg into a round hole. This Court has emphasized that the primary concern of the negative Commerce Clause is "economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Davis*, 553 U.S. at 337-38 (internal quotation marks omitted). Correspondingly, the Court has stressed that "[t]he dormant Commerce Clause protects markets and participants in markets, not taxpayers as such." *General Motors Corp. v. Tracy*, 519 U.S. 278, 300 (1997).

Given these objectives, it should be obvious that state income taxes on individual residents—a traditional means of raising revenue to pay for benefits enjoyed by those same residents—will seldom raise a threat of forbidden economic competition among the states. Not surprisingly, no indication of "economic protectionism" is present here. The Maryland tax scheme does not burden "out-of-state competitors," and Maryland residents earning income across state lines pay *less* income tax to Maryland than residents whose income is earned solely in Maryland. Whatever the term "economic protectionism" might encompass, it cannot sensibly reach a state tax system that provides

more favorable treatment to those taxpayers who engage in interstate commerce.

The Court of Appeals thought otherwise, finding that the Maryland tax scheme "creates a disincentive for the taxpayer . . . to conduct income-generating activities in other states with income taxes." Pet. App. 16. But, as we have pointed out, it is impossible to attribute the multi-state income tax burden to Maryland alone. Furthermore, there is no reason to suppose that the Maryland General Assembly, in choosing to allow partial but not full credits for out-of-state taxes, had a goal of discouraging out-of-state work. To the contrary, it is perfectly clear that the Legislature's guiding motivation was a desire to make sure that Maryland residents, wherever they worked, paid at least some income tax to support government programs, particularly those administered by the State's local governments.[16] Finally, neither the Court of Appeals nor the Wynnes have offered any reason for believing that the State's tax policy—which has been in effect for more than 40 years—has *in fact* deterred Maryland residents from working elsewhere. Thus, any fears about "economic protectionism" in this context are purely theoretical.

4. Political Solutions. The lower court's effort to prevent multiple taxation of Maryland residents not

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[16] Reacting to the decision in *Stern v. Comptroller*, 271 Md. 310 (1974), which had held, on statutory grounds, that the credit for out-of-state taxes applied to both the State tax and the County tax, the General Assembly enacted emergency legislation to repeal the credit against the County tax. *See Blanton*, 390 Md. at 541-42. That change eliminated the possibility that a Maryland resident could avoid paying any Maryland income taxes whatsoever.

only lacks a basis in the Constitution, it improperly interferes with political decisionmaking. Maryland resident taxpayers are fully entitled to participate in the give-and-take of Maryland's political process, and Maryland residents who are dissatisfied with the State's tax policies can vote for different ones. The availability of that political recourse affects the legal calculus as well. Precisely because state residents are "able to complain about and change [a challenged] tax through [their state's] political process," this Court has emphasized that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Goldberg*, 488 U.S. at 266.

The political sphere in which democratic debates about tax policy can be conducted is not confined to State and local government forums. The Commerce Clause, after all, is first and foremost a positive grant of authority to Congress, and Congress remains free, within the proper bounds of that authority, to address any genuine concerns about harm to interstate commerce. Indeed, to the extent that competing state interests prevent the states from devising solutions to policy problems involving state taxation of personal income, Congress is well-positioned, given its national perspective, to weigh taxpayer complaints about multiple taxation against the states' compelling need to fund the benefits extended to their residents. *See Patsy v. Board of Regents of Florida*, 457 U.S. 496, 513 (1982) ("The very difficulty of these policy considerations, and Congress' superior institutional competence to pursue th[e] debate, suggests that legislative not judicial solutions are preferable.").

The democratic process provides ample space for the clash of competing contentions about Maryland tax policy in general and about the tax credit at issue here in particular. But the answer to those contested policy questions is not to be found in the Constitution, and the Maryland Court of Appeals erred in invoking the dormant Commerce Clause as a basis for creating a judicially-enlarged tax credit as a substitute for the one selected by the Maryland General Assembly.

CONCLUSION

The judgment of the Court of Appeals of Maryland should be reversed.

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RESPONDENT'S BRIEF

No. 13-485

IN THE
Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the Maryland Court of Appeals

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QUESTION PRESENTED

Whether a state tax that exposes interstate commerce to double taxation is saved from invalidation under the Commerce Clause merely because the State imposes the tax upon its own residents.

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IN THE

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No. 13-485

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

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BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the Maryland Court of Appeals

BRIEF FOR RESPONDENTS

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause provides: "The Congress shall have Power * * * [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes * * *." U.S. Const. art. I, § 8, cl. 3. Relevant Maryland Code provisions are reprinted in the addendum to this brief.

INTRODUCTION

This case begins and ends with a settled rule: States cannot burden interstate commerce by subjecting it to double taxation (or the risk thereof) that intrastate commerce does not bear. *MeadWestvaco Corp.* v. *Illinois Dep't of Revenue*, 553 U.S. 16, 24 (2008); *J.D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307,

311 (1938); Jerome R. Hellerstein, Walter Hellerstein & John A. Swain, *State Taxation* ¶ 8.02 (3d ed. 2014) (*State Taxation*). The Court has applied that rule many times to strike down State taxes—including taxes on the State's own residents—that create a risk of duplicative taxation. Those cases control this one. Maryland has broken from its sister States and amended its tax code in a way that punishes its residents for making money across state lines; those residents, many of them small businesspeople, are taxed twice on the same income. All parties agree that that atypical tax scheme subjects interstate commerce to double taxation—indeed, the Comptroller of Maryland came right out and admitted it below. The tax scheme also fails the internal-consistency test this Court uses to ferret out duplicative tax burdens on interstate commerce. The Comptroller effectively admits that, too, by refusing to apply the test in his brief.

Maryland's tax therefore is obviously invalid if the usual Commerce Clause rules apply. The only question for this Court, then, is whether they do. The answer is yes. A state tax is "subject to the strictures of the Commerce Clause" if it "substantially affects interstate commerce," *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 614 (1981), and this tax does. The State's tax scheme discourages interstate commerce by penalizing tens of thousands of small businesspeople and business owners for operating across state lines. That is a far more substantial effect than the cases require.

Rather than contest any of this, the Comptroller ignores most of the Commerce Clause jurisprudence and asks this Court to adopt a brand-new limitation on the Clause's coverage: The Clause protects inter-

state commerce *unless* that commerce is engaged in by individuals resident in the taxing State. That proposal is, frankly, astonishing. It punishes residents for doing business across state lines. It removes a broad swath of this Nation's interstate commerce from the Commerce Clause's protection. And it flatly contradicts precedent: The Comptroller says Maryland can double-tax at will because its tax is "based on the status of residency," Comptroller Br. 9, but this Court has long rejected the idea that such formalistic labels matter and instead has simply asked whether the tax substantially affects interstate commerce. The Comptroller also says Maryland has the sovereign power to tax all its residents' income wherever earned, but that is a non sequitur: Respondents agree that Maryland has the sovereign power to impose its tax, but even taxes within the State's "sovereign power" must yield when they offend the Commerce Clause. *Brown* v. *Maryland*, 25 U.S. (12 Wheat.) 419, 449 (1823) (Marshall, C.J.). The Comptroller's invocation of state sovereignty distracts from the actual issue presented.

The Comptroller's approach, in short, amounts to the triumph of buzzwords over precedent. It should be rejected. The rule he proposes would authorize every State to do what the Commerce Clause forbids: "exert[] an inexorable hydraulic pressure on interstate businesses to ply their trades within the State * * * rather than 'among the several States.'" *American Trucking Ass'ns* v. *Scheiner*, 483 U.S. 266, 286-287 (1987) (quoting U.S. Const. art. I, § 8, cl. 3). Moreover, it would create a bizarre situation in which C corporations—the Nation's biggest and wealthiest companies—are protected from double taxation, while S corporations, other pass-through

entities, and the Nation's millions of unincorporated small businesspeople are not. That result is both unjust and doctrinally unsound. Individuals can, and do, engage in interstate commerce just as large corporations do. The Commerce Clause cannot protect one form of interstate commerce and not the other. The decision below should be affirmed.

COUNTERSTATEMENT

A. Maryland's Partial-Credit Scheme

1. Like 40 other States, Maryland imposes a broad-based income tax on its residents who are natural persons. National Conference of State Legislatures, *State Personal Income Taxes* (2012).[1] The tax is levied on all of a resident's income, wherever earned, with some adjustments. Md. Code Ann., Tax-Gen. §§ 10-101(e) & (i), 10-102, 10-103(a), 10-203. It consists of two parts: a so-called "State income tax," whose rate depends on the taxpayer's income, and a so-called "county income tax," whose rate depends on the county where the taxpayer resides. *Id.* §§ 10-105(a), 10-106. Notwithstanding these labels, both are legally deemed state taxes and collected by the Comptroller. *Frey* v. *Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011); Pet. App. 5.

Also like many States, Maryland taxes nonresidents on the income they earn within Maryland's borders. Md. Code Ann., Tax-Gen. §§ 10-102, 10-203, 10-210; Comptroller Br. 4 n.2. Nonresidents pay the same "State" income-tax rate as residents. Md. Code Ann., Tax-Gen. § 10-105(a). They also pay either the "county income tax" where they work, *id.* § 10-

[1] *Available at* http://goo.gl/h60JHi.

103(a)(4), or a "special nonresident tax" in lieu of the "county income tax," *id.* § 10-106.1. The "special nonresident tax" is set equal to the lowest "county" income-tax rate. *Id.*

2. When residents earn income out of State, that income may be subject to taxation by both the State where they earned it and the State where they reside. *See State Taxation* ¶ 20.04[1][a]. To eliminate this risk of multiple taxation, States with broad-based income taxes typically grant their residents a full credit for taxes paid on out-of-state income to other States. *See id.* ¶ 20.04[2].

Not Maryland. Maryland residents may claim a credit against the "State" portion of Maryland's tax on income earned out of State. Md. Code Ann., Tax-Gen. § 10-703(a), (c)(1). But they may not claim any credit against the "county" portion. Pet. App. 7. As a result, Maryland residents are taxed twice at the state level on income they earn in other States: Even if they have already paid tax on that income to the State where it was earned, they must still pay the full "county" portion of Maryland's tax on the same income. The Maryland General Assembly established this scheme quite intentionally; it "amended the income tax statutes to prohibit specifically the application of the out-of-state tax credit to county income tax." *Frey*, 29 A.3d at 492; Pet. App. 7.

B. Maxim Healthcare and the Wynnes

1. Maxim Healthcare Services, Inc., is a national healthcare services company headquartered in Howard County, Maryland. Pet. App. 55. Maxim does business nationwide, and in 2006—the tax year at issue—it earned income in nearly every State. J.A. 10, 77; Pet. App. 9.

Maxim is an "S corporation." J.A. 10. Unlike traditional C corporations, which include publicly traded companies such as General Electric or Apple, S corporations are pass-through entities akin to partnerships. That means they "elect to pass corporate income, losses, deductions and credit through to their shareholders" for tax purposes. IRS, *S Corporations*.[2] Their shareholders, in turn, "report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates." *Id.* Under federal and Maryland law, an S corporation shareholder's income is treated "as if [it] were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation." 26 U.S.C. § 1366(b); *see* Pet. App. 8; William R. Christian & Irving M. Grant, *Subchapter S Taxation* ¶ 1.17 (4th ed. 2000). As a result, when an S corporation does business and earns income in multiple States, the income is attributed to its owners and those owners must pay taxes in many States, just like partners in a law firm.[3]

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[2] *Available at* http://goo.gl/FvIDAL.

[3] *Amicus* the Multistate Tax Commission suggests (Br. 4, 10, 11) that S corporation income is "investment" income, akin to stock dividends. That is incorrect for the reasons just explained. And if Maryland *did* treat residents' S corporation income as investment income, it would make the State's tax scheme even more discriminatory than it currently is. Maryland treats *non*residents' S corporation income as personally earned by the nonresident in Maryland. *See* Pet. App. 8. If Maryland were to treat *residents'* S Corporation income differently—as investment income with no situs—that would unconstitutionally discriminate against nonresidents. Perhaps

2. Respondent Brian Wynne was a longtime Maxim employee and part-owner who helped build the company from a local operation to a national business operating in almost every State. In 2006, Wynne was Maxim's president and owned 2.4% of the company. J.A. 10. He and his wife, respondent Karen Wynne, resided in Howard County with their five children. Pet. App. 8-9.

During the 2006 tax year, the Wynnes earned income from two sources: their salaries, including Brian Wynne's salary as Maxim's president, and the income passed through to the Wynnes from Brian Wynne's stake in Maxim. J.A. 19, 58. Credits aside, the Maryland tax on that income would have been $207,984. J.A. 19 (add lines 24 and 31). The Wynnes claimed no credits against their wage income because it was earned within Maryland. They thus paid both "State" and "county" income tax on that income in full.

The Wynnes, however, had already paid tens of thousands of dollars in taxes to other States on the income passed through to them from Maxim. J.A. 10, 19. That was because 39 other States where Maxim did business assessed their own taxes on Maxim or its shareholders on the income earned within their borders. J.A. 77. Yet the Comptroller refused to allow the Wynnes to claim the full $84,550 credit against their Maryland taxes. J.A. 84-86.

That left the Wynnes with thousands of dollars in double taxation. To take one example: In North Carolina, the Wynnes' share of Maxim's income was

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recognizing as much, the Comptroller has not advanced the Commission's rationale in this Court.

$128,702, which resulted in a $9,411 tax bill. J.A. 77-3. But under Maryland's partial-credit scheme, the Wynnes were not entitled to $9,441 in credits. Instead, they could claim only a $6,113 credit—the $128,702 in North Carolina-sourced earnings multiplied by the applicable Maryland "State" rate of 4.75%. *Id.* The Wynnes were thus double-taxed by more than $3,000 on the money Maxim made in North Carolina alone. That pattern repeated itself across the Wynnes' tax return. J.A. 77. In total, they paid over $25,000 more in state income taxes, simply because they (through Maxim) did business across state lines. *See* Pet. 15.

Even with their claimed credits, however, the Wynnes still paid significant state and county income taxes: $42,086 to Maryland and $81,348 to Howard County. J.A. 19 (lines 30 and 31). They also paid thousands more in property taxes to Howard County. Wynnes' C.A. Br. 46 n.17.

C. Decisions Below

1. The Wynnes appealed the Comptroller's decision to the Maryland Tax Court. J.A. 88-93. There, the Wynnes challenged the constitutionality of the State's partial-credit scheme under the dormant Commerce Clause. Pet. App. 10. The Tax Court rejected their arguments. Pet. App. 135-136.

The Wynnes sought judicial review in the Howard County Circuit Court, which reversed. Pet. App. 53-126. The court held that by allowing state residents with out-of-state income only a partial credit against their state income taxes, Maryland authorizes "double taxation" and "substantially burdens its residents conducting business in interstate commerce, as compared to those conducting purely intrastate

commerce." Pet. App. 54. The court accordingly held that Maryland's tax scheme violates the Commerce Clause. Pet. App. 126.

2. The Comptroller appealed, and the Maryland Court of Appeals accepted review before briefing in the intermediate appellate court. Pet. App. 11.

In the Court of Appeals, the Comptroller argued that Maryland's partial-credit scheme did not implicate interstate commerce. Comptroller C.A. Opening Br. 9-20. The Court of Appeals disagreed. It held that Maryland's partial-credit system implicated interstate commerce because the double taxation "creat[es] a disincentive for the taxpayer * * * to conduct income-generating activities in other states with income taxes." Pet. App. 16-17. The court then analyzed Maryland's scheme under the *Complete Auto* test and found it was neither fairly apportioned nor neutral toward interstate commerce. Pet. App. 17-32; *see Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). It therefore violated the dormant Commerce Clause. Pet. App. 34.

3. The Comptroller moved for reconsideration. Pet. App. 51a. In that motion, he admitted that Maryland's partial-credit scheme results in double taxation. Comptroller C.A. Recons. Mot. 2-3, 9. He also admitted that this double taxation "*make[s] it more difficult to conduct a business that crosses state lines.*" *Id.* at 3 (emphasis added). But he nonetheless asserted that the Commerce Clause does not constrain Maryland's power to double-tax its own residents' interstate income. *Id.* at 2, 5.

The Court of Appeals denied reconsideration. Pet. App. 50-52. It clarified, however, that its decision does not require Maryland to offer credits for taxes

paid to other States. Instead, it requires only that Maryland remedy the double taxation imposed by its partial-credit scheme; Maryland may choose among granting a full credit, dividing the tax base, or some other method. Pet. App. 51-52.

SUMMARY OF ARGUMENT

I. "[T]he commerce clause forbids" state taxes that subject "[i]nterstate commerce * * * to the risk of a double tax burden to which intrastate commerce is not exposed." *J.D. Adams*, 304 U.S. at 311. The Court has reiterated that teaching again and again for nearly a century. It resolves this case. Maryland has enacted an income-tax scheme that systematically causes the double taxation of those who earn money across state lines. "[I]ntrastate commerce," meanwhile, is "not exposed" to that double taxation. *Id.* And Maryland creates that result quite intentionally, by refusing to do what its sister States do: grant its residents a full credit for income taxes they pay to other States.

That tax scheme is "indistinguishable from a type of law previously held unconstitutional by this Court." *United Haulers Ass'n* v. *Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 348 (2007) (Scalia, J., concurring in part) (quotation marks omitted). Since 1938, this Court's Commerce Clause jurisprudence has invalidated state tax laws that subject a State's domiciliaries to multiple taxation, or the risk thereof, as the consequence of engaging in interstate commerce. *See, e.g.*, *J.D. Adams*, 304 U.S. at 311; *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U.S. 653, 662-663 (1948). That is what Maryland's credit scheme does. It therefore is no surprise that the tax flunks the *Complete Auto* test this Court

uses to determine whether a tax violates the Commerce Clause. Maryland's scheme cannot stand.

II. Notably, the Comptroller's brief never applies the *Complete Auto* test, and it never denies that Maryland's tax subjects interstate commerce to multiple taxation. Instead, the Comptroller tries to float above the Commerce Clause jurisprudence and casts about for some exception to the rule that interstate commerce may not be double-taxed. Every theory he advances has been rejected by this Court.

The Comptroller primarily argues that Maryland has the sovereign power to tax all its residents' income, wherever earned. Respondents agree, but the proposition does not help Maryland: This Court has held for 200 years that taxes within the State's "sovereign power" to impose nonetheless must yield when they offend the Commerce Clause. *Brown,* 25 U.S. at 449. Moreover, the Court has struck down numerous state laws that caused multiple or discriminatory taxation, *even though those taxes were imposed on the State's own residents.* If the Comptroller's sovereignty argument were correct, all those cases would be wrongly decided.

The Comptroller also argues that Maryland is not imposing a burden on interstate commerce at all—and thus that the Commerce Clause does not apply—because its income tax is based on a "status": that of being a resident. But this Court has long rejected the formalistic notion that it matters how a tax is labeled—whether, for instance, it is deemed a tax on property, or a "privilege" tax, or a tax on a "local incident." The question instead, in every case, is whether the tax substantially affects interstate commerce. *See Camps Newfound/Owatonna, Inc.*

v. *Town of Harrison*, 520 U.S. 564, 574 (1997) ("A tax on real estate, *like any other tax*, may impermissibly burden interstate commerce." (emphasis added)); *Commonwealth Edison*, 453 U.S. at 615 (the Court has "long * * * rejected" the notion that a state tax "affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to a 'local' or 'intrastate' activity"). Maryland's tax unquestionably has such a substantial effect. On the facts here, it discourages interstate activity by a corporation that operates in dozens of States. And more generally, it punishes interstate activity by every single pass-through entity and unincorporated small businessperson domiciled in the State. The Commerce Clause applies, and Maryland must abide by its strictures.

Finally, the Comptroller argues that Maryland *must* be allowed to double-tax interstate commerce because otherwise local residents will not pay their share for state services. The argument is specious. The Wynnes still would pay substantial income taxes to Maryland even with a full credit, and the same goes for almost everyone earning money across state lines. Moreover, States levy many other taxes on their residents, from sales taxes to property taxes to fees, and thus every resident contributes to the cost of state services in that way too. Indeed, the Wynnes themselves paid significant property taxes to Maryland. Finally, States provide extensive services to domiciliary *corporations*—fire protection, water, roads—and yet States cannot double-tax those corporations. Maryland's argument thus proves too much. The State has every right to tax to fund the services it provides. But it cannot do so by subject-

ing interstate commerce to burdens that intrastate commerce does not bear.

III. The Comptroller's proposed categorical exception to the Commerce Clause therefore cannot be reconciled with precedent. And it would have a bizarre result: States would be forbidden to double-tax domiciliary *C* corporations but would be free to double-tax domiciliary *S* corporations and resident small businesspeople to the hilt. That rule makes absolutely no sense; each kind of business engages in interstate commerce in equal degree. And the Comptroller makes no attempt to justify it.

The United States does acknowledge the issue, U.S. Br. 30-32, but the weakness of its arguments only underscores how problematic this point is for Maryland. The United States argues that a State's "relationship" with its individual residents differs from its "relationship" with its domiciliary corporations. It is difficult to see, however, why this is so—both corporations and individuals are resident in a particular State or States, and both receive state services—or why it makes a constitutional difference. The United States also says, boldly, that "it is an open question whether States are constitutionally *required* to apportion the income of a domestic corporation"—in other words, it argues that maybe States can double-tax C corporations too. *Id.* at 31. That will come as news to the Nation's corporations, given that this Court has long held that States *must* structure their taxes to avoid multiple taxation of interstate business.

In the end, Maryland lacks any justification for its project here: to blow a gaping hole through the

Commerce Clause's protections for interstate commerce. The decision below should be affirmed.

ARGUMENT

I. MARYLAND'S PARTIAL-CREDIT SCHEME VIOLATES THE COMMERCE CLAUSE.

A. The Commerce Clause Forbids States To Burden Interstate Commerce With The Risk Of Multiple Taxation.

1. The problem in this case is simple. In our national economy, commerce often crosses state lines. And when that happens, two or more States may seek to tax the same commercial event.

Consider the person who resides in State A but does business in both State A and State B. Because she does business in State B, State B has jurisdiction to tax the income she earns within its borders. *See Shaffer* v. *Carter*, 252 U.S. 37, 57 (1920). And because she resides in State A, State A has jurisdiction to tax all of her income, even income earned in State B. *See Oklahoma Tax Comm'n* v. *Chickasaw Nation*, 515 U.S. 450, 462-463 (1995) ("[A] jurisdiction * * * may tax *all* the income of its residents, even income earned outside the taxing jurisdiction * * * ."); *Lawrence* v. *State Tax Comm'n*, 286 U.S. 276, 279 (1932). Thus, when a person who resides in State A earns income in State B, both States have jurisdiction to tax the income she earns in State B.

This overlapping jurisdiction creates a problem for interstate commerce, because the person who does business across state lines is exposed to a risk that others are not: the risk of multiple taxation. The question in this case is whether the Constitution tolerates this burden on interstate commerce.

2. It does not. The Commerce Clause gives Congress the Power "[t]o regulate Commerce with foreign Nations, and among the several States." U.S. Const. art. I, § 8, cl. 3. "Although the Constitution does not in terms limit the power of States to regulate commerce," this Court has "long interpreted the Commerce Clause as an implicit restraint on state authority, even in the absence of a conflicting federal statute." *United Haulers*, 550 U.S. at 338. And while "the Court's understanding of the dormant Commerce Clause has taken some turns," *Oklahoma Tax Comm'n* v. *Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995), one thing has remained constant for generations: This Court has held that the Clause forbids the risk of multiple taxation.

Thus, nearly 80 years ago in *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250 (1938), this Court declared that "interstate business * * * shall not be burdened with cumulative exactions which are not similarly laid on local business." *Id.* at 258. The Court's opinion, written by then-Justice Stone, traced that rule to one of the Court's earliest dormant Commerce Clause decisions: the *Case of the State Freight Tax*, 82 U.S. (15 Wall.) 232 (1873). The Court there struck down a state tax on merchandise carried in interstate commerce. *Id.* at 271. The reason for that decision, Justice Stone explained, was that if "every state" imposed an identical tax, "interstate commerce * * * would bear cumulative burdens not imposed on local commerce." *Western Live Stock*, 303 U.S. at 256.

This Court has reaffirmed that basic teaching in case after case. It has said, for example, that "multiple taxation of interstate operations * * * offends the Commerce Clause." *Central R.R. Co. of Pa.* v. *Penn-*

sylvania, 370 U.S. 607, 612 (1961) (quotation marks omitted). It has admonished States not to "subject[] interstate commerce to the burden of multiple taxation." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 458 (1959) (quotation marks omitted). And it has struck down state taxes whenever they violate this rule. *See, e.g.*, *Evco* v. *Jones*, 409 U.S. 91, 94 (1972) (per curiam) (invalidating state gross-receipts tax that subjected interstate commerce to "the risk of a double tax burden to which intrastate commerce is not exposed" (quotation marks omitted)); *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157, 170 (1954) (invalidating state tax on taking natural gas to avoid "a multiple burden upon that commerce" (quotation marks omitted)); *Standard Oil Co.* v. *Peck*, 342 U.S. 382, 385 (1952) (invalidating state tax on river vessels to avoid "multiple taxation of interstate operations").

It is therefore beyond question that, "[i]n reviewing state taxation schemes under the Commerce Clause," this Court "act[s] as a defense against state taxes which * * * give rise to serious concerns of double taxation." *Trinova Corp.* v. *Michigan Dep't of Treasury*, 498 U.S. 358, 386 (1991). As this Court recently reiterated, the "Commerce Clause forbids the States to levy taxes * * * that burden [interstate commerce] by subjecting activities to multiple or unfairly apportioned taxation." *MeadWestvaco*, 553 U.S. at 24; *see State Taxation* ¶¶ 6.03, 8.02[1].

3. State income taxes are no exception to this long-settled rule. Time and again, this Court has invalidated state income taxes on Commerce Clause grounds because they burdened interstate commerce with the threat of multiple taxation. And despite the Comptroller's contrary suggestions (Br. 12, 24-26),

the Court has done so even when the tax fell on residents of the taxing State.

In *J.D. Adams*, for example, this Court struck down an Indiana tax on "the gross income of every resident of the State," regardless of where the income was earned. 304 U.S. at 308; *see id.* at 316 (describing tax as a "tax demanded on appellant's gross income from its business in interstate commerce"). The tax was challenged by one of the State's residents—a corporation that earned income selling goods out-of-state. *Id.* at 308-309. The Court agreed that the tax violated the Commerce Clause. It wrote that the "vice of the statute" was that it "include[d] in its measure, without apportionment, receipts derived from activities in interstate commerce." *Id.* at 311. And if the tax were upheld, other States could lay the same "exaction," thereby subjecting "[i]nterstate commerce * * * to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids." *Id.*

The Court reached a similar conclusion in *Gwin, White & Prince, Inc.* v. *Henneford*, 305 U.S. 434 (1939). That case involved a tax levied by Washington on the "gross income" of "every person" doing business in the State, no matter where the income was earned. *Id.* at 435 (quotation marks omitted). A Washington corporation challenged the tax, *id.*, and this Court struck it down. "If Washington is free to exact such a tax," the Court explained, "other states to which the commerce extends may, with equal right, lay a tax similarly measured for the privilege of conducting within their respective territorial limits the activities there which contribute to the service." *Id.* at 439. The Court concluded: "The present tax, though nominally local, thus in its

practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed." *Id.*

The Court's decision in *Central Greyhound*, 334 U.S. 653, is to the same effect. New York sought to tax the gross income of its own domiciliary—a New York bus company whose routes crossed into New Jersey and Pennsylvania. *See id.* at 654; *id.* at 664-665 (Murphy, J., dissenting) (identifying plaintiff as a "New York corporation"); *Jefferson Lines*, 514 U.S. at 190 (explaining that the Court understood the tax in *Central Greyhound* to be "simply a variety of tax on income"). In invalidating the tax, the Court emphasized that New Jersey and Pennsylvania might also seek to tax the company's receipts, at least with respect to mileage within their respective borders. *See Central Greyhound*, 334 U.S. at 662. And that meant the company "was exposed to taxation by New Jersey and Pennsylvania on portions of the same receipts that New York was taxing in their entirety." *Jefferson Lines*, 514 U.S. at 190. The Court concluded that this risk of multiple taxation imposed an "unfair burden" on interstate commerce. *Central Greyhound*, 334 U.S. at 662.

The lesson from these cases is clear: The Commerce Clause forbids taxes, including income taxes, that subject interstate commerce to the risk of multiple taxation. When two or more States have jurisdiction to tax the same income, the Commerce Clause requires a credit, division of the tax base, or some other mechanism to eliminate that risk.

B. Maryland's Scheme Burdens Interstate Commerce With The Risk (And Reality) Of Multiple Taxation.

Because Maryland's partial-credit scheme cannot be squared with these principles, it cannot stand.

1. Maryland's scheme is indistinguishable from laws previously invalidated by this Court. In *J.D. Adams*, *Gwin*, and *Central Greyhound*, this Court struck down state income taxes that exposed interstate commerce to a risk of multiple taxation. There is no principled way to distinguish those taxes from the law at issue here.

Consider, for instance, the tax struck down in *J.D. Adams*: a tax on "the gross income of every resident of the State." 304 U.S. at 308. That is precisely the type of tax at issue here: a tax on the gross income of every resident of the State. *See* Md. Code Ann., Tax-Gen. § 10-101(i) (defining "Maryland taxable income" as "Maryland adjusted gross income, less the exemptions and deductions allowed under this title"). To be sure, Maryland's income tax can be broken down into "State" and "county" components. *Id.* §§ 10-102, 10-103(a)(1), 10-105(a), 10-106. But "the county tax * * * *is* a state tax," so these labels do not matter. *Frey*, 29 A.3d at 492 (emphasis added). As in *J.D. Adams*, the tax at issue is a tax on the gross income of every resident of the State.

As in *J.D. Adams*, moreover, the tax exposes the State's residents to a risk of multiple taxation. What was true when this Court decided *J.D. Adams* is true today: A person's income is taxable not only by the State where she resides, but also by the State where she earns it. *Chickasaw Nation*, 515 U.S. at 463 & n.11. And that means that absent a credit or some

other method of apportionment, a Maryland resident with interstate income is subject to a risk of multiple taxation. In *J.D. Adams*, the Court struck down Indiana's scheme because it did not eliminate that risk. *See* 304 U.S. at 311. Here, Maryland's scheme similarly fails to eliminate that risk, because Maryland grants only "partial but not full credits for out-of-state taxes." Comptroller Br. 41; *see* Md. Code Ann., Tax-Gen. § 10-703(a). Like the tax in *J.D. Adams*, the Maryland tax subjects "[i]nterstate commerce * * * to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids." 304 U.S. at 311.

J.D. Adams controls this case—as do *Gwin* and *Central Greyhound*. In each, the State sought to tax the gross income of persons domiciled in the State. And in each, the State exposed interstate commerce to the risk of multiple taxation, with no method to eliminate that risk. Principles of *stare decisis* command that the outcome here should be the same as in *J.D. Adams*, *Gwin*, and *Central Greyhound*. The state law should be struck down. *See Quill Corp.* v. *North Dakota*, 504 U.S. 298, 320 (1992) (Scalia, J., joined by Kennedy and Thomas, J.J., concurring in part and concurring in the judgment) (*stare decisis* has "special force" in dormant Commerce Clause context because "Congress remains free to alter what [this Court] has done" (quotation marks omitted)).

2. Analyzing Maryland's income-tax scheme under this Court's four-part *Complete Auto* test yields the same result: Maryland's law must fall.

Under *Complete Auto*, this Court "examine[s] the practical effect of a challenged tax to determine whether it '[1] is applied to an activity with a sub-

stantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.'" *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 443 (1980) (quoting *Complete Auto*, 430 U.S. at 279). "[N]o tax may be sustained" under the Commerce Clause unless it meets all four prongs. *Maryland* v. *Louisiana*, 451 U.S. 725, 754 (1981). Maryland's income tax flunks prongs two and three: It is not fairly apportioned, and it discriminates against interstate commerce.

Start with the second prong. A state tax is not "fairly apportioned" unless it is "internally consistent." *Goldberg* v. *Sweet*, 488 U.S. 252, 261 (1989). The internal consistency test ferrets out any risk of multiple taxation. "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Id.* The question, in other words, is whether "identical application [of the tax] by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Jefferson Lines*, 514 U.S. at 185.

Here the answer is clear: If every State adopted Maryland's tax scheme, interstate income would be subjected to multiple taxation nationwide. Recall that Maryland taxes the entire income of all its residents, wherever earned. Md. Code Ann., Tax-Gen. §§ 10-102, 10-103(a)(1). It also taxes the income of nonresidents earned within the State's borders, and refuses to fully credit residents for taxes owed in another State. *Id.* §§ 10-102, 10-103(a)(4), 10-106.1, 10-210, 10-703(a). Thus, if every State

adopted Maryland's tax scheme, income earned by residents out of State would be taxed twice: once by the State of the income's source, and again by the State of the taxpayer's residence. And residents would receive only partial credit for taxes owed out of State, creating double taxation. Maryland's scheme is thus internally inconsistent, because adoption of an identical scheme by every other State would "add [a] burden to interstate commerce that intrastate commerce would not also bear." *Jefferson Lines*, 514 U.S. at 185; *see also Central Greyhound*, 334 U.S. at 662-663 (conducting similar analysis in striking down State's income tax); *Gwin*, 305 U.S. at 439 (same); *J.D. Adams*, 304 U.S. at 311 (same); *State Taxation* ¶ 8.02[3] ("[A] state * * *, which seeks to tax the unapportioned income of its domiciliary corporations doing business in other states while taxing an apportioned share of the income of foreign corporations doing business within the state, violates the Court's 'internal consistency' principle.").

An example illustrates the point. Assume every State has adopted Maryland's scheme, imposing a 4.75% "State" income tax on residents and nonresidents alike, in addition to a 1.25% "county" income tax on residents and an equivalent 1.25% "special nonresident tax" on nonresidents. John resides in Home State and earns an income of $200,000, all within Home State. His total income-tax burden—owed entirely to Home State—will be $12,000, calculated by multiplying $200,000 by the overall Home State income-tax rate of 6%.

Like John, Mary resides in Home State and has an income of $200,000. But unlike John, Mary engages in interstate commerce. Although she earns half her income in Home State, she earns the other half in

Neighboring State. Absent any apportionment, she will owe $12,000 to Home State, calculated by multiplying her total income of $200,000 by the overall Home State income-tax rate of 6%. She will also owe $6,000 to Neighboring State, calculated by multiplying her Neighboring State income of $100,000 by the overall Neighboring State income-tax rate of 6%. Home State, however, will credit her for only the "State" portion of the taxes on her Neighboring State income—which amounts to $4,750, or $100,000 multiplied by 4.75%. So Mary's total income-tax burden will be $13,250—$7,250 owed to Home State and $6,000 owed to Neighboring State.

As this example shows, Mary ends up owing $1,250 more in taxes than John, just because she does business across state lines. That added burden results from the double taxation of Mary's income earned in a different State. And because that burden falls on interstate commerce alone—without affecting intrastate commerce at all—the tax is not internally consistent. Maryland's law is not fairly apportioned under *Complete Auto*. *See Jefferson Lines*, 514 U.S. at 185.

It follows that Maryland's law also discriminates against interstate commerce within the meaning of *Complete Auto*'s third prong. As this Court has held, "[a] tax that unfairly apportions income from other States is a form of discrimination against interstate commerce." *Armco Inc.* v. *Hardesty*, 467 U.S. 638, 644 (1984). Here Maryland's tax subjects income from other States to the risk of multiple taxation. That discriminates against interstate commerce by "plac[ing] burdens on the flow of commerce *across* [a State's] borders that commerce *wholly within* those borders would not bear." *Jefferson Lines*, 514 U.S. at

180 (emphases added); *see also Armco*, 467 U.S. at 642. To borrow the words of this Court in *Gwin*, "[t]he present tax, though nominally local, * * * in its practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed." 305 U.S. at 439.

That is not a burden interstate commerce should have to bear. It is true that "even interstate business must pay its way, and the bare fact that one is carrying on interstate commerce does not relieve him from many forms of state taxation which add to the cost of his business." *Western Live Stock*, 303 U.S. at 254 (quotation marks and citations omitted). But it is one thing for "different States" to tax "*distinct* events" along "the stream of commerce." *Jefferson Lines*, 514 U.S. at 187-188 (emphasis added). It is quite another for different States to tax the *same* income within that stream. Though interstate commerce can be made to "pay its way," it cannot be made to pay *twice*. *See Western Live Stock*, 303 U.S. at 256-258.

3. By forcing interstate commerce to pay twice, Maryland's tax strikes at "the very purpose of the Commerce Clause," which "was to create an area of free trade among the several States." *Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388, 402 (1984) (quotation marks omitted). Free trade requires the removal of barriers to commerce crossing state lines. But Maryland's scheme exposes to multiple taxation the earning of income beyond the State's borders, "exert[ing] an inexorable hydraulic pressure on interstate businesses to ply their trades within the State * * * rather than 'among the several States.'"

Scheiner, 483 U.S. at 286-287 (quoting U.S. Const. art. I, § 8, cl. 3). Specifically, it discourages small businesspeople, and pass-through entities with Maryland owners, from plying their trades across state lines, thereby denying other States' citizens access to goods and services offered by Marylanders. Pet. App. 16-17.

The Maryland law's effect is therefore to "reestablish the barriers to interstate trade which it was the object of the commerce clause to remove." *Gwin*, 305 U.S. at 440. And it would encourage other States to erect similar barriers. After all, reducing tax credits is a politically appealing solution for States looking to plug persistent budget gaps. "[A] loss of [a] credit is, in effect, a tax increase on every dollar of that taxpayer's income," Mark H. Neikrie, *Connecticut's Personal Income Tax*, 65 Conn. B.J. 345, 362 n.96 (1991) (quotation marks omitted), and it is a tax increase the legislature can accomplish under the radar, "without the political cost of raising tax rates." Ronald D. Auctt, *The "2% Floor" Grows Up*, 33 ACTEC J. 214, 217 (2008).

Maryland's partial-credit scheme, in short, cannot be squared with settled precedent, and it fails the *Complete Auto* test. It is invalid under the dormant Commerce Clause.

4. This is not to say there is a "single constitutionally mandated" way of structuring a state income-tax scheme. *Goldberg*, 488 U.S. at 261 (quotation marks omitted). Although the Commerce Clause forbids States to burden interstate commerce with the risk of multiple taxation, it does not dictate any particular method of eliminating that risk.

One way of avoiding multiple taxation is for States to do what most *already* do: grant full credit against their income tax for income taxes paid to other States. That would "cure the discrimination" against interstate commerce, *Tyler Pipe Indus., Inc.* v. *Washington State Dep't of Revenue*, 483 U.S. 232, 249 (1987), and render the State's tax internally consistent, by ensuring that interstate commerce is not subject to double-taxation burdens that intrastate commerce does not face. *See id.* at 245 n.13 (recognizing that credits can eliminate potential for multiple taxation); *Goldberg*, 488 U.S. at 264 (same); *D. H. Holmes Co.* v. *McNamara*, 486 U.S. 24, 31 (1988) (same).

Another way of curing the discrimination would be for States to divide their residents' tax base, to avoid taxing all their income in the first place. States (including Maryland) already apply formulas for apportioning the tax base of a C corporation so that a State does not, "when imposing an income-based tax, tax value earned outside its borders." *Container Corp. of Am.* v. *Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) (quotation marks omitted); *see also Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 276-280 (1978) (discussing single- and three-factor formulas adopted by various States); Md. Code Ann., Tax-Gen. § 10-402(a) (requiring apportionment of C corporation income). States could apply similar apportionment formulas to their individual residents, to avoid taxation of any "extraterritorial values." *Container Corp.*, 463 U.S. at 164 (quotation marks omitted). That would eliminate the potential for multiple taxation because when a State apportions, "multiple burdens logically cannot occur." *Department of Revenue* v. *Association*

of Wash. Stevedoring Cos., 435 U.S. 734, 746-747 (1978).

What States may not do is none of the above. But that is what Maryland has done here. Its law places an unconstitutional burden on interstate commerce, and should be invalidated.

II. THE COMPTROLLER'S ARGUMENTS CANNOT SAVE MARYLAND'S UNCONSTITUTIONAL SCHEME.

Tellingly, the Comptroller makes no serious attempt to apply *Complete Auto*, and he never denies that Maryland's scheme double-taxes in theory and in practice. Quite the opposite: He has conceded that it does. *E.g.*, Comptroller C.A. Recons. Mot. 9 (asserting that "some degree of double taxation, in the form at issue here, is unavoidable"). The only question, then, is whether the Commerce Clause applies. Of course it does. The scheme at issue "substantially affects" interstate commerce in exactly the same manner as the improperly apportioned taxes in a host of past cases; it therefore is "subject to the strictures of the Commerce Clause." *Commonwealth Edison*, 453 U.S. at 614.

Ignoring the substantial-effects test, the Comptroller relies on notions of "jurisdiction," "residence," and political process in his effort to carve out an exception to the scope of the Commerce Clause. Each argument fails.

A. The Comptroller's Due-Process And Sovereignty Arguments Duck The Commerce Clause Question At Issue.

1. The Comptroller spills much ink (Br. 18-19, 27-29) proving a point the Wynnes have never contested: that a State has the raw jurisdictional power to

tax its residents on all the income they earn, no matter where they earn it. But proving that proposition does not decide the case. In scores of cases in which this Court has applied the Commerce Clause to invalidate a state tax, the State had undisputed jurisdiction to levy the tax: The tax either fell on a resident's income, *see, e.g.*, *J.D. Adams*, 304 U.S. at 311; or on money earned in the taxing State, *see, e.g.*, *Tyler Pipe*, 483 U.S. at 235; or on property in the taxing State, *see, e.g.*, *Camps Newfound*, 520 U.S. at 574. But that did not matter. The operative question instead was, and is, whether a tax otherwise within the State's taxing authority "offend[s] the Commerce Clause." *Commonwealth Edison*, 453 U.S. at 617. If it does, it cannot stand.

The cases the Comptroller cites do not suggest otherwise. In each, the Court's holding rested on the *Due Process Clause*, without addressing the Commerce Clause's distinct limitations. Such cases do not help the Comptroller because "[a] tax may be consistent with due process and yet unduly burden interstate commerce." *Quill*, 504 U.S. at 313 n.7.

Every one of the Comptroller's cases is limited in this way. In *Lawrence*, 286 U.S. 276, for instance, the Court held that a State may impose an income tax "on its own citizens with reference to the receipt and enjoyment of income derived from the conduct of the business, regardless of the place where it is carried on." *Id.* at 281. The Comptroller quotes this excerpt. *See* Comptroller Br. 18. But he fails to mention that the taxing statute in *Lawrence* "was challenged on the ground that in so far as it imposes a tax on income derived wholly from activities carried on outside the state, *it deprived [the challenger]*

of property without due process of law." 286 U.S. at 279 (emphasis added).

So, too, in *People ex rel. Cohn* v. *Graves*, 300 U.S. 308 (1937), this Court held that "[a] state may tax its residents upon net income from a business whose physical assets [are] located wholly without the state." *Id.* at 313. But the Court explicitly "limit[ed] [its] review to the question considered and decided by the state court, whether there is anything *in the Fourteenth Amendment* which precludes the State of New York from taxing the income merely because it is derived from sources" outside of New York. *Id.* at 312 (emphasis added). Moreover, the case was tried on a "stipulation of facts" that did "not indicate that [the plaintiff's] income ha[d] been taxed by New Jersey"—the only other State that could seek to do so—and so no issue of multiple taxation was even raised. *Id.* at 311.

The Comptroller's (and the United States') other cited cases are similarly inapplicable. *See State Tax Comm'n* v. *Aldrich*, 316 U.S. 174, 174 (1942) ("sole question" presented was whether Utah was "precluded by the Fourteenth Amendment from imposing" a contested inheritance tax); *Curry* v. *McCanless*, 307 U.S. 357, 372 (1939) (due-process challenge); *Guaranty Trust Co. of New York* v. *Virginia*, 305 U.S. 19, 22-23 (1938) (same); *Shaffer*, 252 U.S. at 58 (same); *Maguire* v. *Trefry*, 253 U.S. 12, 15 (1920) (same); *Fidelity & Columbia Trust Co.* v. *City of Louisville*, 245 U.S. 54, 54, 58 (1917) (same). Indeed, *Aldrich*—one of the Comptroller's favorite precedents—is even further off-base. There the domiciliary State's inheritance tax "allowed as a credit * * * the amount of any constitutionally valid estate or inheritance tax

paid to any other state." 316 U.S. at 175. Thus, no double taxation could arise on the case's facts.

Chickasaw Nation, another of the Comptroller's most heavily cited cases, is likewise inapposite. The Comptroller relies on a footnote in that decision, which in turn quoted an American Law Institute publication, stating: "'[I]f foreign income of a domiciliary taxpayer is exempted, this is an independent policy decision and not one compelled by jurisdictional considerations.'" 515 U.S. at 463 (quoting American Law Institute, *Federal Income Tax Project: International Aspects of United States Income Taxation* 6 (1987)). According to the Comptroller, that means the Commerce Clause places no limit on a State's taxation of its residents' income.

But that is not what the footnote says. What it describes as an "independent policy decision" is "*exempt[ing]*" foreign income. And "exempt[ing]" foreign income means excluding it from the tax base altogether. *See* Center on Budget & Policy Priorities, *Policy Basics: Tax Exemptions, Deductions, and Credits* 1-2 (Apr. 16, 2013).[4] The footnote is correct that the Constitution does not compel exemptions; it allows a jurisdiction to choose between exempting the income—i.e., dividing the tax base—and any other method of avoiding multiple taxation, including credits. And the Court in *Chickasaw Nation* made clear that neither multiple taxation nor any question about credits was presented in the case: In the very next footnote, it wrote that the question presented was "a narrow one" because the plaintiff did not "complain that Oklahoma fails to award a

[4] *Available at* http://goo.gl/6ro3QL.

credit against state taxes for taxes paid to" another jurisdiction. 515 U.S. at 464 n.13. That is why the Court limited its discussion to "*jurisdictional* considerations," *id.* at 463 n.12 (emphasis added), which have nothing to do with the Commerce Clause. *See Nippert* v. *City of Richmond*, 327 U.S. 416, 423-424 (1946) (distinguishing "due process or 'jurisdictional'" considerations from Commerce Clause considerations).[5]

By contrast, in cases where the Commerce Clause question *was* presented, this Court has invalidated state taxes that impose a risk of multiple taxation or that discriminate against interstate commerce—and it has done so even when the State was taxing its own residents. *See, e.g., Camps Newfound*, 520 U.S. at 567, 595 (striking down tax imposed on resident corporation); *Fulton Corp.* v. *Faulkner*, 516 U.S. 325, 327-328 (1996) (striking down tax that applied to resident natural persons as well as resident corporations); *Central Greyhound*, 334 U.S. at 662-663 (same); *Gwin*, 305 U.S. at 435 (same); *J.D. Adams*, 304 U.S. at 308 (same). These cases are irreconcilable with the Comptroller's argument. If the Comp-

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[5] Moreover, the quoted publication did not concern the U.S. Constitution at all. It instead concerned "general principles that have international acceptance," American Law Institute, *supra*, at 4—and those same international principles distinguish between "jurisdictional considerations" and considerations of double taxation. The sentences immediately following the one quoted in *Chickasaw Nation* state: "When one country taxes on the basis of domiciliary jurisdiction and another country taxes on the basis of source, the same income will be taxed twice. Under internationally accepted practice, it is incumbent on the domiciliary jurisdiction to alleviate this double taxation by some reasonable means." *Id.* at 6.

troller were correct, each would have come out the other way. This Court would have held that the State has jurisdiction to tax all income of its residents without limitation, even if double taxation followed, and it would have gone no further.

2. There is a reason why this Court has taken care to separate the Due Process and Commerce Clause analyses: "[T]he Due Process Clause and the Commerce Clause reflect different constitutional concerns." *Quill*, 504 U.S. at 305. The Due Process Clause regulates individuals' relationship with the State. *Collins* v. *City of Harker Heights*, 503 U.S. 115, 126 (1992). The Commerce Clause, by contrast, regulates States' relationships with each other. *See, e.g.*, *Case of the State Freight Tax*, 82 U.S. at 279. A state action that does not infringe its citizens' rights may still hobble commerce among the States.

Thus, as the Court has explained, "'[t]here may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax against due process objections.'" *Quill*, 504 U.S. at 305-306 (quotation marks omitted). Yet the tax "'may fall because of its burdening effect upon the commerce.'" *Id.* at 306 (quotation marks omitted). Put differently, a tax's validity under the Commerce Clause "'depends upon * * * considerations of constitutional policy having reference to the substantial effects, actual or potential, of the particular tax in suppressing or burdening unduly the commerce'" not present in the Due Process Clause. *Michigan-Wisconsin Pipe Line*, 347 U.S. at 164 (quoting *Nippert*, 327 U.S. at 424).

But rather than heed this Court's warning that the Due Process and Commerce Clause questions "are

analytically distinct," *Quill*, 504 U.S. at 305, the Comptroller conflates them. His position appears to be that so long as each State claiming a share of a taxpayer's income has jurisdiction to tax under the Due Process Clause, there is no Commerce Clause problem with multiple taxation. Comptroller Br. 13, 28. But that would mean this Court was wrong when it held that "[a] tax may be consistent with due process and yet unduly burden interstate commerce." *Quill*, 504 U.S. at 313 n.7. It also would make nonsense of every case in which (i) the State had undisputed jurisdiction to tax and yet (ii) this Court invalidated the tax on multiple-taxation grounds. *See, e.g.*, *Evco*, 409 U.S. at 93-94; *Michigan-Wisconsin Pipe Line*, 347 U.S. at 163-164, 170; *Standard Oil*, 342 U.S. at 384; *Central Greyhound*, 334 U.S. at 662-663; *Gwin*, 305 U.S. at 438-440. Indeed, in *J.D. Adams* the dissent pointed out that the State had jurisdiction to tax all of its residents' income, citing *Shaffer* and *Cohn*—the same cases the Comptroller relies on here. *J.D. Adams*, 304 U.S. at 330 n.21 (Black, J., dissenting). The Court nevertheless invalidated the State's income tax because it subjected interstate commerce "to the risk of a double tax burden." *Id.* at 311 (majority opinion). The Comptroller's proposition would require the wholesale overruling of this Court's precedents.

The United States asserts exactly the converse: It claims that due process must impose the only relevant restriction on a State's power to tax its residents because a contrary rule would "effectively overrule specific precedents." U.S. Br. 13. But the "specific precedents" it points to are the same due-process cases the Comptroller cites. *Id.* at 13-14. The United States' argument therefore is a mere

restatement of the Comptroller's over-read of those cases. And its claim that the Wynnes' position would "overrule" the due-process precedents is absurd. This Court already has struck down discriminatory and multiplicative taxes imposed on residents in a host of cases, *see supra* at 31-32, and those rulings did not overturn due-process precedent. The due-process cases and Commerce Clause cases simply address separate issues.

3. Perhaps aware of the risk of relying solely on a State's *jurisdiction* to tax, the Comptroller and the United States pitch this as a case about Maryland's *sovereignty*. The Comptroller's brief is a veritable paean to state sovereignty; the word appears 20 times. But as with the Comptroller's closely related due-process argument, its sovereignty argument misses the point: States do enjoy extensive sovereign power to tax, but that sovereign power must yield when a tax offends the Commerce Clause.

This Court has so held since the earliest days of the Republic. Indeed, Chief Justice Marshall made exactly this point in rejecting a sovereignty argument advanced by none other than Maryland. In *Brown*, Maryland argued that applying the Commerce Clause to a state tax "would abridge the acknowledged power of a state to tax its own citizens or their property within its territory." 25 U.S. at 448. Chief Justice Marshall brushed the argument aside, observing that "the taxing power of the States must have some limitation" and that the taxing power, though "sacred," "cannot reach and restrain the action of the national government within its proper sphere." *Id.* Thus, he wrote, even taxes that are "within the [States'] sovereign power of taxation" must be struck down where they would "derange the

measures of Congress to regulate commerce and affect materially the purpose for which that power was given." *Id.* at 449. The States' sovereign power to tax had to yield to the national-uniformity demands of the Commerce Clause.

The Court has adhered to that principle through time. It has explained that the States' "power to lay and collect taxes, as comprehensive and necessary as that power is, cannot be exerted in such a way" as to unduly burden interstate commerce. *Pennsylvania* v. *West Virginia*, 262 U.S. 553, 596 (1923); *accord Lacoste* v. *Department of Conservation*, 263 U.S. 545, 549 (1924). And it has explained why that limitation is consistent with State sovereignty: Through their ratification of the Constitution, "[a]ll the states have assented to [the Commerce Clause], all are alike bound by it, and all are equally protected by it." *Pennsylvania*, 262 U.S. at 596. In our federalist system, each State agreed to cede some of its sovereign taxing powers to reap the benefits of "a national 'common market.'" *Hunt* v. *Washington State Apple Advertising Comm'n*, 432 U.S. 333, 350 (1977). That Maryland's taxing policies have been limited in some small way by that agreement is no reason to cast aside the Commerce Clause.

4. The Comptroller raises a second sovereignty concern: He says the Court of Appeals' decision makes the constitutionality of Maryland's tax scheme dependent on the tax choices of other States, which "severely diminishes one of the core attributes of sovereignty." Comptroller Br. 30-32; *accord* U.S. Br. 10-12. That is incorrect. It is the *risk* of multiple taxation that renders Maryland's scheme unconstitutional. Accordingly, Maryland's scheme is unconstitutional regardless of whether other States actually

exercise their jurisdiction to tax the Wynnes' income earned within their borders.

As this Court long ago explained, the "unlawfulness of the burden" a state tax imposes "depends on its nature, measured in terms of its *capacity* to obstruct interstate commerce, and not on the contingency that some other state may have first subjected the commerce to a like burden." *Gwin*, 305 U.S. at 440 (emphasis added). Put another way, the Commerce Clause forbids state taxes that subject "[i]nterstate commerce * * * to the risk of a double tax burden to which intrastate commerce is not exposed." *J.D. Adams*, 304 U.S. at 311. Whether such a risk exists depends on only one thing: the structure of the State's own tax.

That principle is put to action in *Complete Auto*'s internal-consistency requirement. By hypothesizing a world in which each State has a tax identical to the one challenged, the test measures the *potential* for double taxation; whether the tax actually results in double taxation is irrelevant. Indeed, the Court has rejected the argument that a taxpayer invoking internal consistency must "prove actual discriminatory impact." *Armco*, 467 U.S. at 644. The reason: "Any other rule would mean that the constitutionality of [a State's] tax laws would depend on the shifting complexities of the tax codes of 49 other States." *Id.* at 644-645. Far from undercutting the Court of Appeals' analysis, as the United States claims (Br. 22), *Armco* confirms that Maryland's tax is unconstitutional regardless of any other State's tax policy.

The United States similarly misunderstands *Mobil Oil*'s statement that "the constitutionality of [one State's] tax should not depend on the vagaries of

[another State's] tax policy." 445 U.S. at 444; *see* U.S. Br. 12. That statement is just another articulation of the principle articulated in *Armco*. Indeed, in a later passage, *Mobil Oil* makes clear that it means exactly the opposite of what the United States suggests: Rather than bless double taxation, the Court noted that when two States have jurisdiction to tax the same income—thus creating a risk of double taxation—"apportionment is ordinarily the accepted method." *Mobil Oil*, 445 U.S. at 445-446. *Mobil Oil* thus "hold[s] squarely that that the Commerce Clause protects taxpayers against the risk, and not merely the actuality of multiple taxation." *State Taxation* ¶ 4.09[1][a].[6]

The Comptroller protests that the rule against multiple taxation creates the "intractable problem of deciding which of two legitimate state taxes should take precedence over the other." Comptroller Br. 30. Yet, for decades, this Court has held that when more than one State seeks to tax the same income, the income should be "'fairly apportioned'" to the "'business done within each State.'" *Central Greyhound*,

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[6] *Moorman*, on which the United States relies (Br. 28), is not to the contrary. In *Moorman*, two States took steps to eliminate the risk of multiple taxation, but used different formulas for apportioning a business's income. 437 U.S. at 276. Each formula was internally consistent, and the Court held that the possibility that the two formulas might inadvertently overlap did not rise to the level of a constitutional violation. *Id.* at 276-280. Here, by contrast, Maryland has not sought to eliminate the risk of multiple taxation. It has instead chosen deliberately to create an internally inconsistent tax that denies its residents a full credit for taxes paid to other States. It is that choice which the Commerce Clause forbids. *See MeadWestvaco*, 553 U.S. at 24.

334 U.S. at 663 (quoting *Western Live Stock*, 303 U.S. at 255); *see also Standard Oil*, 342 U.S. at 384 ("The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all the property by the state of domicile."); *Mobil Oil*, 445 U.S. at 445-446 (same in income-tax context). That rule makes sense, because it ensures that no State is left with less than its fair share of the tax revenue: Each may tax commerce conducted within its borders. The Comptroller's objection inexplicably overlooks this Court's fair-apportionment holdings.

It also overlooks the fact that "all states with broad-based income taxes"—some 40 in all—"provide a credit for taxes paid by their residents to other states." *State Taxation* ¶ 20.04[2]. The Comptroller and his *amici* try to undermine that uniformity, but they are able to identify only three States besides Maryland that supposedly fail to grant such a credit in full. International Municipal Lawyers Association (IMLA) Br. 17. And even that modest claim is exaggerated: Only one of those States categorically refuses, like Maryland, to grant a full credit. *See* Wis. Admin. Code § 2.955(3)(d). North Carolina, contrary to *amici*'s claim, allows a credit against any taxes paid "to another state" and has not determined if county and city taxes qualify as "state" taxes, as they do in Maryland. *See* N.C. Gen. Stat. § 105-153.9(a)(1). And we have previously explained why Tennessee's credit scheme is consistent with the decision below (Br. in Opp. 22), yet *amici* never acknowledge—much less refute—that analysis.[7]

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[7] *Amici*'s attempt to identify local taxes imperiled by the Court of Appeals' decision (IMLA Br. 17-18) is similarly sus-

That more than three dozen States already embrace credits for out-of-state income earned by their residents belies any suggestion that enforcing the rule against multiple taxation is impossible. It likewise belies the Comptroller's assertions that such a rule will trigger widespread uncertainty, Br. 30-32, or that it will prevent States from funding state services, Br. 20-24. Maryland is the outlier. Other States have had no trouble running their tax systems without saddling their residents with blatant double taxation.

To be sure, as the United States observes (Br. 12), under a full-credit system other States' choices may affect the amount *collected* by Maryland's tax—just as they do under Maryland's present system. But that does not mean other States' choices have any impact on the *constitutionality* of Maryland's scheme. They do not. Indeed, the amount collected by a state tax is often affected by matters outside a State's control, such as the profit a resident's business earns or the migration of residents into or out of a State. To say that Maryland might collect variable amounts from a constitutionally designed tax is to say little about the Commerce Clause question in this case.

For all these reasons, the Comptroller's first argument—that Maryland's jurisdiction and sovereign

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pect. *Amici* cut-and-paste their certiorari-stage argument regarding the Philadelphia tax without mentioning the Pennsylvania credit statute, *see* Br. in Opp. 26-27, and string-cite statutes and webpages without any meaningful analysis. Suffice it to say few local taxes appear to be implicated by the decision below. *See* Supp. Br. 4-5. *Amici*'s cherry-picked survey does not suggest otherwise.

power to tax mean it may expose interstate commerce to unlimited double taxation—fails.

B. The Comptroller's Attempt To Elevate The "Status Of Residency" Over The Substantial-Effects Test Fails.

The Comptroller's second argument is just as insubstantial. He argues that Maryland's tax does not implicate the Commerce Clause at all because it is "based upon" the "status" and "privilege" of Maryland residency. Comptroller Br. 3, 11, 15, 16, 19, 37, 39. This remarkable claim seeks to rewind this Court's Commerce Clause jurisprudence at least a half-century, to a time when formalism ruled the day. It fails for two separate reasons: First, Maryland's tax is *not* based upon residency; it is based upon income. Second, what the tax is "based upon" is irrelevant; the question is whether it substantially affects interstate commerce. The tax at issue here clearly does.

1. The Comptroller posits that the incidence of Maryland's income tax falls upon residency, Comptroller Br. 18-19, 37-40, but under the statutes' plain terms, it does not. Both the "State" and "county" portions of the income tax are levied "on the Maryland taxable income" of the taxpayer. Md. Code Ann., Tax-Gen. §§ 10-102, 10-103(a). In other words, the tax is *measured by* income. It is therefore *based upon* income—and nothing else. *See Hunt-Wesson, Inc.* v. *Franchise Tax Bd.*, 528 U.S. 458, 464 (2000) ("[A] tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." (quotation marks omitted)).

Maryland's treatment of nonresidents confirms the point. Maryland levies both portions of its income

tax on nonresidents: The "State income tax" applies to "each individual," without respect to residency, Md. Code Ann., Tax-Gen. § 10-102, and the "county income tax" applies to "nonresident[s] who derive[] income from salary, wages, or other compensation for personal services for employment in the county," *id.* § 10-103(a)(4). Moreover, nonresidents who are not subject to the "county income tax" have to pay the "special nonresident tax" instead. *Id.* § 10-106.1; *see also Frey*, 29 A.3d at 505 (holding that the "special nonresident tax" is a "compensatory" substitute for the "county" tax). Because Maryland taxes the income of nonresidents, its income tax cannot be described as a tax on residency. Indeed, this Court recognized exactly that point in *J.D. Adams*: It held that an income tax could "not [be] an excise for the privilege of domicile alone, since it is levied upon the gross income of *non-residents* from sources within the State." 304 U.S. at 310 (emphasis added). Just so here.

2. Even if the Maryland income tax were "based on" the "privilege" or "status" of residence, however, it still would be subject to the Commerce Clause. That is because the notion that the Clause's protections switch on and off depending on how a tax is labeled, or what kind of tax it is, has long been consigned to the dustbin.

In the past, this Court thought labels significant. Thus, for example, the Court held in the first half of the last century that a levy labeled as a tax on the "privilege of exercising corporate functions within the State" was permissible, while a tax on "the privilege of doing interstate business" was not. *Complete Auto*, 430 U.S. at 282-285 (recounting earlier decisions). It held that a tax on the "privilege

of using [the State's] highways" was permissible, while a tax on carrying on interstate commerce was not. *Scheiner*, 483 U.S. at 293 (quoting *Aero Mayflower Transit Co.* v. *Board of R.R. Comm'rs*, 332 U.S. 495, 503 (1947)). And in *Freeman* v. *Hewit*, 329 U.S. 249 (1946)—a case quoted four times by the Comptroller—the Court "embraced again the formal distinction between direct and indirect taxation," invalidating a tax because it "would 'impos[e] a direct tax on interstate sales.'" *Quill*, 504 U.S. at 309-310 (quoting *Freeman*, 329 U.S. at 256). These cases created a landscape in which "the use of magic words or labels" marked the difference between constitutional and unconstitutional levies. *Railway Express Agency* v. *Virginia*, 358 U.S. 434, 441 (1959); *see State Taxation* ¶¶ 4.08-4.11 (tracing doctrinal development).

This Court overturned all of that in *Complete Auto*. That opinion "renounced the *Freeman* approach as 'attaching constitutional significance to a semantic difference.'" *Quill*, 504 U.S. at 310 (quoting *Complete Auto*, 430 U.S. at 285). Such formalism, the Court wrote, "merely obscures the question of whether the tax produces a forbidden effect." *Complete Auto*, 430 U.S. at 288. The Court thus held that henceforth it would "consider[] not the formal language of the tax statute but rather its practical effect." *Id.* at 279.[8]

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[8] The Comptroller heavily emphasizes the Court's statement in *Freeman* that a State "can tax the privilege of residence in the State and measure the privilege by net income, including that derived from interstate commerce." 329 U.S. at 255; *see* Comptroller Br. 11, 16, 19, 39. But that statement means only that there is no *per se* rule against such a tax. *See Freeman*,

The Court has hewed to that approach since, emphasizing that States may not "avoid the strictures of the dormant Commerce Clause" by labels alone. *Camps Newfound*, 520 U.S. at 575. The kind of tax—real estate, property, sales, income—and how "local" it is likewise do not matter: The Court has "long since rejected any suggestion that a state tax or regulation affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to a 'local' or intrastate activity," *Commonwealth Edison*, 453 U.S. at 615, and accordingly has explained that "[a] tax on real estate, *like any other tax*, may impermissibly burden interstate commerce." *Camps Newfound*, 520 U.S. at 574 (emphasis added). The question, instead, is one of substantial effect: A state tax is "subject to the strictures of the Commerce Clause" if it "substantially affects interstate commerce." *Commonwealth Edison*, 453 U.S. at 614; *accord, e.g.*, *Michigan-Wisconsin Pipe Line*, 347 U.S. at 164.

3. The Comptroller's focus on labels therefore fails. Moreover, through his silence he has waived any argument on the real question: whether Maryland's tax substantially affects interstate commerce.

There can be no doubt of the answer anyway. As explained, *see supra* at 19-25, Maryland's tax burdens interstate commerce with the risk (and the

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329 U.S. at 255 (citing *U.S. Glue Co.* v. *Town of Oak Creek*, 247 U.S. 321 (1918), which rejected the claim that a tax on the privilege of residence was *per se* unconstitutional as a "direct" tax on interstate commerce). Such a tax is still unconstitutional if it "produces a forbidden effect," *Complete Auto*, 430 U.S. at 288—which Maryland's tax does by subjecting interstate commerce to the risk of multiple taxation.

reality) of multiple taxation. That burden affects interstate commerce in ways much more substantial than this Court has heretofore required.

By providing only a partial credit, Maryland's tax penalizes interstate commercial activity to the tune of $50 million per year, by the State's own estimation. Pet. 15. That penalty discourages tens of thousands of Maryland businesspeople "from plying their trades in interstate commerce," *Fulton*, 516 U.S. at 333, as the Court of Appeals concluded, Pet. App. 16-17. The Comptroller does not dispute that conclusion. On the contrary, he has admitted it, telling the Maryland high court that the State's tax scheme causes double taxation that "make[s] it more difficult to conduct a business that crosses state lines." Comptroller C.A. Recons. Mot. 3.[9]

Quite so. And that is precisely the sort of burden that implicates the Commerce Clause. *See Fulton*, 516 U.S. at 333 (discriminatory tax on ownership of interstate corporations' stock implicated Commerce Clause because it discouraged interstate commerce); *Boston Stock Exch.* v. *State Tax Comm'n*, 429 U.S. 318, 336 (1977) (discriminatory tax on transfer of securities implicated Commerce Clause because "the flow of securities sales [was] diverted from the most

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[9] The Comptroller also has conceded the substantial-effects question in a second way: by acknowledging (Br. 42) that Congress has authority to legislate in this area. After all, "[t]he definition of 'commerce' is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation." *Hughes* v. *Oklahoma*, 441 U.S. 322, 326 n.2 (1979). If Congress has authority to legislate, that necessarily means the tax falls within the Commerce Clause's coverage.

economically efficient channels and directed to" the taxing State); *Camps Newfound*, 520 U.S. at 574 (tax that discouraged local camp from serving out-of-state campers "clearly ha[d] a substantial effect on commerce"). Indeed, if the tax in *Camps Newfound* substantially affected interstate commerce, it follows *a fortiori* that this one does. The tax there discouraged interstate activity by a summer camp with "revenues * * * averaging about $400 per week for each student." 520 U.S. at 567. The tax here discourages interstate activity by a multi-state corporation with millions of dollars in annual revenues, and more generally by every sole proprietorship and pass-through entity in the State.

Tax on "residence" or not, then, Maryland's partial-credit scheme must avoid the risk of double taxation. It does not. It is therefore unconstitutional.

C. The Comptroller's Efforts To Justify His Residency Exception Are Unpersuasive.

The Comptroller tries to justify his radical rule—that the Commerce Clause does not protect interstate commerce so long as the tax happens to land on a State's residents—by declaiming at length about the services States provide to their residents. Comptroller Br. 20-24. He also argues that the protections of the Commerce Clause must yield because the State's political process will solve the problem. *Id.* at 24-26. These arguments fail on several levels.

1. To begin with, they do nothing to answer the key doctrinal point: If the connection between a State and its residents were enough to preclude relief under the Commerce Clause, then many of this Court's cases—both old and new—were wrongly decided. *See supra* at 31-32. The plaintiff in

J.D. Adams was an Indiana corporation challenging an Indiana tax, and this Court struck it down as unconstitutionally duplicative. 304 U.S. at 308, 311-312. The plaintiff in *Gwin* was a Washington corporation challenging a Washington tax, and this Court struck it down. 305 U.S. at 435, 439. The plaintiff in *Central Greyhound* was a New York corporation challenging a New York tax, and this Court struck it down. 334 U.S. at 662-663. And the taxpayers in *Fulton* and *Camps Newfound* were North Carolina and Maine domiciliaries, respectively, each challenging their own States' taxes on Commerce Clause grounds. *Fulton*, 516 U.S. at 328, 333-344; *Camps Newfound*, 520 U.S. at 568, 576-583. This Court struck them both down.

If "resident" status were enough to take a case outside of the Commerce Clause, then all these cases came out the wrong way. That just underscores that the Comptroller is focused on the wrong issue. The key question is not whether the Wynnes are Maryland residents; it is whether Maryland's tax imposes undue burdens on interstate commerce. This Court has never removed a whole category of cases from that sensible analysis. It should not start now.

The Comptroller's only answer is a cursory footnote: He suggests that while the Commerce Clause does not protect individuals, it *does* protect domiciliary corporations like those in the above cases because domiciliary corporations "do not possess the capacity to effect change by voting" as natural persons do. Comptroller Br. 25 n.12. That is a surprising claim, given that Maryland told the Court in 2009 that corporations can exercise "'significant and disproportionate influence'" in the state political process. Br. for State of Montana et al. as *Amici*

Curiae at 15-16, *Citizens United* v. *FEC*, 558 U.S. 310 (2010) (No. 07-2240) (filed July 31, 2009, by a coalition of States including Maryland). Moreover, even if corporations cannot vote, their resident officers, shareholders, and employees can, and "[a] corporation is simply a form of organization used by human beings to achieve desired ends." *Burwell* v. *Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2768 (2014).

The Comptroller's assertions about voters' ability to eliminate discriminatory taxes also blink at political reality. The political process could arguably be an adequate safeguard—if at all—only when a burdensome tax broadly affects the State's residents. *See West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186, 200 (1994); *Fort Gratiot Sanitary Landfill, Inc.* v. *Michigan Dep't of Natural Res.*, 504 U.S. 353, 370 (1992) (Rehnquist, C.J., dissenting) (political process relevant when the state policy burdens "all the State's consumers"). Here, by the Comptroller's own calculation, this case affects only approximately 50,000 to 55,000 taxpayers, out of a total of 2.83 million returns. *See* Comptroller C.A. Recons. Mot., Aff. of Andrew Schaufele, Ex. 1; Comptroller of Maryland, *Personal Income Tax, Statistics of Income, Tax Year 2011*, at tbl.1 (2014).[10]

The "voting" distinction on which the Comptroller seizes is of dubious constitutional relevance anyway. The Commerce Clause, after all, is "informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." *Quill*,

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[10] *Available at* http://goo.gl/VIHNG0.

504 U.S. at 312. The Comptroller thus grossly overreads *Goldberg*'s dictum that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes." 488 U.S. at 266; *see* Comptroller Br. 42. As one court has observed, *Goldberg* simply stands for the "obvious proposition" that "[t]he commerce clause is not designed to protect taxpayers of the taxing state, but to protect interstate commerce" by blocking taxes that unfairly burden it. *Woosley* v. *California*, 838 P.2d 758, 769 (Cal. 1992). It does not mean, as the Comptroller seems to think, "that a tax can never offend the commerce clause so long as it is levied on residents of the taxing state"—a proposition that is "inconsistent with a long line of prior decisions rendered" by this Court. *Id.* (collecting cases); *see supra* at 31-32 (same).

In short, Marylanders should not have to rely on the Maryland General Assembly's grace to engage in interstate commerce free of duplicative taxation. "To carry on interstate commerce is not a franchise or privilege granted by the State; it is a right which every citizen of the United States is entitled to exercise." *Dennis* v. *Higgins*, 498 U.S. 439, 448 (1991) (quotation marks omitted). If the Comptroller believes there should be an exception to that rule, he is focused on the wrong political process. Interstate commerce is a national concern, and the only political body that can create an exception to the rule against double taxation is Congress. *See Lewis* v. *BT Inv. Managers*, 447 U.S. 27, 44 (1980).

2. The Comptroller nonetheless insists that double taxation of its residents is appropriate because States "provide their residents with a host of financial benefits" and should be able to ask for a "fair

return." Comptroller Br. 14, 20; *see id.* at 20-24. There are many answers. First, this Court's cases have never suggested that is a good enough reason to burden interstate commerce. *See supra* at 45-46. Second, dozens of States with income taxes provide a full credit, *see supra* at 38-39, and they apparently still believe they have obtained a "fair return" from their residents.

Third, Maryland ignores the fact that the double-taxed income at issue in this case was earned out of state. If there is any State that could claim a "fair return" on that income, it is the State where the income was earned—not Maryland. That is presumably why States, including Maryland, have decided to tax that nonresident income in the first place—to get a "fair return" for the services they provided that make that income possible. As this Court has explained, nonresident income taxes allow states to "make interstate commerce pay its way." *Northwestern States*, 358 U.S. at 464 (quotation marks omitted).

Finally, Maryland vastly exaggerates when it suggests that residents who earn income in interstate commerce will escape paying for state services. Such residents typically pay property taxes in the State where they live. They pay sales taxes. And they pay income taxes to their State of residence on all of their income sourced to the State—a point the Comptroller ignores.[11]

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[11] Moreover, residents of *other* States who earn money in Maryland pay taxes to Maryland on that money, even though they cannot access the cherry-picked list of resident-only services the Comptroller catalogues. And the Wynnes pay such

The Wynnes' own experience illustrates the point: They had substantial Maryland-sourced income, both through wages and through Maxim's Maryland activities, and they paid more than $123,000 in Maryland income taxes in 2006 alone. J.A. 19 (lines 30 and 31). They also paid substantial property taxes, though the record does not reveal the precise amount. The notion that they seek to free-ride is offensive; they seek instead not to be taxed by multiple States on the same income.

Nor is the Wynnes' experience unusual. The available data underscores that Maryland can offer a full credit and still collect the vast majority of the taxes it has always collected, including nearly all of those used to fund schools and other local services. In 2012, Maryland collected $7.69 billion from individual income taxes, Sheila O'Sullivan et al., *State Government Tax Collections Summary Report: 2013*, at 6 (Apr. 8, 2014),[12] and it asserts that $45 to $50 million per year is at stake in this case, Pet. 15. Crediting its high-end estimate, that means it would lose 0.6% of its income-tax collections. The Comptroller says this prevents him from imposing the taxing system Maryland's legislators feel most fair. Comptroller Br. 41-42. But sometimes, like here, "the freedom of the States to formulate independent policy [in the interstate taxation] area may have to yield to an

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taxes in other States for services *they* cannot access. The effects the Comptroller bemoans even out when one views the tax liabilities of multi-state businesspeople in a less parochial fashion.

[12] *Available at* http://goo.gl/FRNWcj.

overriding national interest in uniformity." *Moorman*, 437 U.S. at 280.

More broadly, States' individual income-tax collections nationwide are dwarfed by their collections of property, sales, and gross-receipts taxes. In 2011, local governments raised more than $429 billion from property taxes and more than $93 billion from local sales and gross-receipts taxes—some 15 times the amount they took in from individual income taxes on business income. *See* Jeffrey L. Barnett & Phillip M. Vidal, *State and Local Government Finances Summary: 2011*, at 6 (July 2013);[13] Ernst & Young LLP, *Total State and Local Business Taxes* (Aug. 2014).[14] And it is these property and sales taxes that primarily finance services such as schools, fire protection, and emergency medical services—the very local services on which the Comptroller focuses. Of the $259.4 billion in local funds spent on schools in 2011, for instance, $170.1 billion came from property taxes, while other taxes combined accounted for only just over $8 billion. Mark Dixon, *Public Education Finances: 2011*, at tbl.4 (May 2013).[15] Similarly, local property taxes are the "most common taxes supporting fire and EMS services nationally." FEMA, *Funding Alternatives for Fire and Emergency Services* 2-1;[16] *see also* U.S. Br. 18 (acknowledging that "property taxes may be a more common source of local revenue than income taxes"). States simply do not need, and are not entitled to, a special consti-

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[13] *Available at* http://goo.gl/2KwBYw.

[14] *Available at* http://goo.gl/zy55YH.

[15] *Available at* http://goo.gl/yq3qx4.

[16] *Available at* http://goo.gl/mQvWLo.

tutional rule to fund local services. "[R]evenue generation is not a local interest that can justify discrimination against interstate commerce." *C & A Carbone, Inc.* v. *Town of Clarkstown*, 511 U.S. 383, 393-394 (1994).

III. THE COMPTROLLER'S RULE PRODUCES AN ABSURD RESULT: PROTECTION AGAINST DOUBLE TAXATION FOR C CORPORATIONS BUT NOT S CORPORATIONS OR INDIVIDUALS.

The end result of the Comptroller's position is not just an undue burden on interstate commerce. It also is a disconnect in the Commerce Clause jurisprudence: States could not double-tax C corporations, but they could double-tax S corporations, other pass-through entities, and small businesspeople to their hearts' content. Nothing in the doctrine or the Comptroller's arguments justifies that bizarre and unjust result.

1. The Comptroller does not question this Court's decisions in *J.D. Adams*, *Gwin*, or *Central Greyhound*, which struck down state income taxes on domiciliary corporations because they contravened the constitutional rule against multiple taxation. And yet the Comptroller urges this Court to uphold Maryland's partial-credit scheme on the theory that a different rule should apply to "[i]ndividual residents." Comptroller Br. 25 n.12.

The Commerce Clause, however, does not confer greater rights on corporations than on individuals. In every case arising under the dormant Commerce Clause, the question is simply "whether the statute under attack, whatever its name may be, will in its practical operation" discriminate against or duplicatively tax interstate commerce. *Halliburton Oil Well Cementing Co.* v. *Reily*, 373 U.S. 64, 69 (1963); *see*

also Nippert, 327 U.S. at 424 n.9; *Gwin*, 305 U.S. at 439; *supra* at 41-45. Here, the practical operation of the partial-credit scheme is the same, regardless of whose income is being taxed. Whether the income belongs to a corporation or an individual, a partial-credit scheme subjects "[i]nterstate commerce * * * to the risk of a double tax burden to which intrastate commerce is not exposed." *J.D. Adams*, 304 U.S. at 311. There is thus no basis for according corporations greater protection under the Commerce Clause. Like corporations, individuals engage in interstate commerce, and when they do, the effect of multiple taxation is no less discriminatory. *See State Taxation* ¶ 20.10[2][b] ("[A] state has no more power under the Commerce Clause to tax individuals on 100 percent of their income earned from commercial activities that are taxable in other states than it has to tax corporations on 100 percent of their income earned from commercial activities that are taxable in other states."). Given that this Court does not distinguish between corporations and individuals when it comes to the affirmative Commerce Clause, *see Wickard* v. *Filburn*, 317 U.S. 111 (1942), there is no basis to make that distinction with respect to the dormant Commerce Clause. *See Hughes* v. *Oklahoma*, 441 U.S. 322, 326 n.2 (1979) ("The definition of 'commerce' is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation.").

The United States nevertheless insists that individuals should be afforded less protection from multiple taxation because they have a "unique" relationship with the State where they reside. U.S. Br. 30. But while the nature of a taxpayer's relation-

ship with her State may be relevant to some constitutional inquiries—such as whether there are sufficient contacts to justify the State's assertion of taxing authority under the Due Process Clause, *see Quill*, 504 U.S. at 306-309—it bears no relevance to whether there is a risk of multiple taxation in violation of the Commerce Clause. That question turns instead on whether the State seeks to tax the same income as another State, without fair apportionment. And the answer does not depend on whether the taxpayer is a corporation or an individual.

In any event, the premise of the United States' argument fails twice over. The United States claims that individuals' relationships with their home States are different from corporations' because an individual can be a resident of only one State, whereas a corporation is often a resident of two—the State of its principal place of business and its State of incorporation. U.S. Br. 31 n.7; *see also* Multistate Tax Commission Br. 11. But individuals are often deemed resident in two States, particularly States—such as New York—with a broad statutory definition of residency. *See State Taxation* ¶ 20.03; *Worchester Cnty. Trust Co.* v. *Riley*, 302 U.S. 292, 299 (1937) ("Neither the Fourteenth Amendment nor the full faith and credit clause requires uniformity in the decisions of the courts of different states as to the place of domicil"). The United States' distinction is a false one.

Moreover, contrary to the Solicitor General's suggestion, a State's relationship with its individual residents is not fundamentally different from its relationships with other taxpayers. It is true, of course, that individual residents receive many local benefits in return for paying income taxes. But

corporations and nonresidents do, too. "When a corporation doing business in a State pays its general corporate income tax, it pays for a wide range of things: construction and maintenance of a transportation network, institutions that educate the work force, local police and fire protection, and so on." *Fulton*, 516 U.S. at 337. Nonresidents also pay for—and benefit from—these same things in the States where they work and earn income. *See supra* at 49. There is nothing about a State's relationship with its individual residents that could justify an exception to the constitutional rule against multiple taxation.

In the end, perhaps recognizing that its distinction between individuals and corporations is anemic, the United States is left to contend that it is an "open question" whether even *C corporations* are constitutionally protected from multiple taxation. U.S. Br. 31. But that truly radical contention cannot be squared with the holdings of *J.D. Adams*, *Gwin*, or *Central Greyhound*. And given those holdings—which the Comptroller does not challenge—the outcome here should not be in doubt. Because there is no principled basis for treating individuals differently than corporations under the Commerce Clause, Maryland's law should be struck down.

2. Finally, even if there were a special rule against multiple taxation for income earned by corporations, that rule would apply here. That is because this case does involve a corporation—an S corporation. And nothing in this Court's cases suggests that the income of an S corporation should be treated any differently than the income of a C corporation for dormant Commerce Clause purposes.

The United States resists this conclusion, arguing that "the purpose and effect of S-corporation designation is that the income is treated as personal income under both Maryland and federal law." U.S. Br. 30 n.6. But the S-corporation designation does not change the fact that the income in question was earned by Maxim, beyond Maryland's borders, in the course of interstate commerce. *See* 26 U.S.C. § 1366(b); Pet. App. 8a. Whether that income is protected from multiple taxation should not depend on whether Maxim elected to be treated as an S corporation instead of a C corporation—an election that is not even available in some States. "[E]quality for the purposes of competition and the flow of commerce is measured in dollars and cents, not legal abstractions." *Halliburton*, 373 U.S. at 70. This Court should not allow the difference between an S corporation and a C corporation to stand in the way of enforcing the Constitution's rule against multiple taxation. *Cf. Camps Newfound*, 520 U.S. at 584 (seeing "no reason why the nonprofit character of an enterprise should exclude it from the coverage of either the affirmative or the negative aspect of the Commerce Clause").

CONCLUSION

The Comptroller and his *amici* pitch Maryland's partial-credit scheme as a "rational compromise," in which it offers *some* credit for out-of-state taxes but truncates it to pay for state services. Comptroller Br. 23; IMLA Br. 16-17. But make no mistake: The rule the Comptroller seeks has no such limiting principle. He proposes "the status of residence" as a categorical exception to the Commerce Clause, and he therefore advocates a regime in which Maryland, and every State, need offer *no* credit for taxes paid to other States on interstate income. They could double-tax their residents in full.

That rule contradicts precedent and would create, for the first time, a two-tier Commerce Clause that discriminates against the Nation's millions of small businesspeople. The judgment of the Maryland Court of Appeals should be affirmed.

Respectfully submitted,

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ADDENDUM

ADDENDUM

RELEVANT MARYLAND CODE PROVISIONS

Md. Code Ann., Tax-Gen. § 10-101 provides:

* * * *

(a) In this title the following words have the meanings indicated.

* * * *

(d) "County income tax" means the county tax on income authorized in § 10-103 of this subtitle.

* * * *

(e) "Federal adjusted gross income" means:

(1) for an individual other than a fiduciary, the individual's adjusted gross income as determined under the Internal Revenue Code;

* * * *

(g) "Individual" means, unless expressly provided otherwise, a natural person or a fiduciary.

* * * *

(i) "Maryland taxable income" means:

(1) for an individual, Maryland adjusted gross income, less the exemptions and deductions allowed under this title;

* * * *

(j) "Nonresident" means an individual who is not a resident.

* * * *

(k) (1) "Resident" means:

(i) an individual, other than a fiduciary, who:

1. is domiciled in this State on the last day of the taxable year; or

2. for more than 6 months of the taxable year, maintained a place of abode in this State, whether domiciled in this State or not;

* * * *

(2) "Resident" includes, for the part of the taxable year that an individual resides in this State, an individual who:

(i) moves to this State with the intent to be domiciled in this State; or

(ii) is domiciled in this State and moves outside this State before the last day of the taxable year with the bona fide intention to remain permanently outside of this State.

* * * *

(*l*) "S corporation" means a corporation that elects to be taxed as a small business corporation under Subchapter S of the Internal Revenue Code.

* * * *

(n) "State income tax" means the State tax on income imposed under this title.

* * * *

Md. Code Ann., Tax-Gen. § 10-102 provides:

> Except as provided in § 10-104 of this subtitle, a tax is imposed on the Maryland taxable income of each individual and of each corporation.

Md. Code Ann., Tax-Gen. § 10-103 provides:

> *In general*
>
> (a) Each county shall have a county income tax on the Maryland taxable income of:
>
> (1) each resident, other than a fiduciary, who on the last day of the taxable year:
>
> (i) is domiciled in the county; or
>
> (ii) maintains a principal residence or a place of abode in the county;
>
> * * * *
>
> (4) except as provided in § 10-806(c) of this title, a nonresident who derives income from salary, wages, or other compensation for personal services for employment in the county.
>
> * * * *

Md. Code Ann., Tax-Gen. § 10-105 (1998) provided:

> (a) The State income tax rate for an individual is:
>
> (1) 2% of Maryland taxable income of $1 through $1,000;
>
> (2) 3% of Maryland taxable income of $1,001 through $2,000;
>
> (3) 4% of Maryland taxable income of $2,001 through $3,000; and

(4) for Maryland taxable income in excess of $3,000:

* * * *

(v) 4.75% for a taxable year beginning after December 31, 2001.

* * * *

Md. Code Ann., Tax-Gen. § 10-106 provides:

In general

(a) (1) Each county shall set, by ordinance or resolution, a county income tax equal to at least 1% but not more than the percentage of an individual's Maryland taxable income as follows:

* * * *

(iii) 3.20% for a taxable year beginning after December 31, 2001.

* * * *

Md. Code Ann., Tax-Gen. § 10-106.1 provides:

In general

(a) An individual subject to the State income tax under § 10-105(a) of this subtitle, but not subject to the county income tax under § 10-106 of this subtitle, shall be subject to the tax imposed under this section.

Rate of tax

(b) The rate of the tax imposed under this section shall be equal to the lowest county income tax rate set by any Maryland county in accordance with § 10-106 of this subtitle.

Distribution of tax

(c) The tax imposed under this section shall be distributed by the Comptroller in accordance with § 2-609 of this article.

Md. Code Ann., Tax-Gen. § 10-203 provides:

Except as provided in Subtitle 4 of this title, the Maryland adjusted gross income of an individual is the individual's federal adjusted gross income for the taxable year as adjusted under this Part II of this subtitle.

Md. Code Ann., Tax-Gen. § 10-210 provides:

In general

(a) The amounts under this section are subtracted from the federal adjusted gross income of a nonresident to determine Maryland adjusted gross income.

Income not derived from business or property not in Maryland

(b) To the extent included in federal adjusted gross income, the subtraction under subsection (a) of this section includes all income other than:

(1) income derived from real or tangible personal property located in the State, whether the income is derived directly or from a fiduciary;

(2) income derived from:

(i) a business that is wholly carried on in the State and in which the individual is a partner, shareholder of an S corporation, member of a limited

liability company as defined under Title 4A of the Corporations and Associations Article, but only to the extent the company is taxable as a partnership under § 761 of the Internal Revenue Code, or proprietor; or

(ii) an occupation, profession, or trade that is wholly carried on in the State;

(3) the part, allocable to the State under § 10-401 of this title, of income derived from:

(i) a business that is carried on both in and out of the State and of which the individual is a partner, shareholder of an S corporation, member of a limited liability company as defined under Title 4A of the Corporations and Associations Article, but only to the extent the company is taxable as a partnership under § 761 of the Internal Revenue Code, or proprietor; or

(ii) an occupation, profession, or trade that is carried on both in and out of the State; and

(4) income from Maryland State Lottery prizes or winnings from any other wagering, as defined in § 10-905(e) of this title, in the State.

Md. Code Ann., Tax-Gen. § 10-703 provides:

Credit allowed

(a) Except as provided in subsection (b) of this section, a resident may claim a credit only

against the State income tax for a taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year.

Exceptions

(b) A credit under subsection (a) of this section is not allowed to:

(1) a resident other than a fiduciary, if the laws of the other state allow the resident a credit for State income tax paid to this State;

(2) a resident fiduciary, if the fiduciary claims, and the other state allows, a credit for State income tax paid to this State;

(3) a resident for less than the full taxable year for tax on income that is paid to another state during residency in that state; or

(4) a nonresident.

Amount of credit for resident

(c) (1) Except as provided in paragraph (2) of this subsection, the credit allowed a resident under subsection (a) of this section is the lesser of:

(i) the amount of allowable tax on income that the resident paid to another state; or

(ii) an amount that does not reduce the State income tax to an amount less than would be payable if the income

subjected to tax in the other state were disregarded.

(2) If the credit allowed a resident under subsection (a) of this section is based on tax that an S corporation pays to another state, the credit allowable to a shareholder:

(i) may not exceed that shareholder's pro rata share of the tax; and

(ii) will be allowed for another state's income taxes or taxes based on income.

REPLY BRIEF

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No. 13-485

In The Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

On Writ of Certiorari to the
Court of Appeals of Maryland

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REPLY BRIEF FOR THE PETITIONER

The Court has long contrasted a state's broad taxing power over its own residents with the more circumscribed authority of a state to tax nonresidents on a "source" basis on income earned from activities within the taxing state's territory. *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). The Wynnes, individual Maryland taxpayers, seek a ruling that limits Maryland's broad taxing authority over its residents and requires the State to tax them in the same manner as nonresidents, that is, on the basis of "source" rather than domicile. Resp. Br. at 36-37, 49. Yet the Wynnes offer neither precedent nor a principled basis for concluding, as they do, *id.* at 49, that the state of residence has a lesser claim on its residents' income than other states in which its residents invest or do business.

Under the Wynnes' analysis, a state's taxing power over its own residents would be confined to income received from sources "within its borders," *id.* at 38; "income earned outside the taxing jurisdiction" would be subject to tax only by the state where the income-generating activities took place, contrary to the until-now "well-established principle" that a state "may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462-63 (1995). In seeking this remarkable outcome, the Wynnes ask this Court both to expand its dormant Commerce Clause jurisprudence and to jettison nearly a century of case law upholding the power of a state to "tax *all* the income of its residents." *Id.*; *see*

also Shaffer, 252 U.S. at 57. The Wynnes offer nothing that supports their novel legal theory and this Court should reject it.

Abandoning arguments made below, the Wynnes rely instead on three supposedly "control[ling]" cases involving taxes on corporate gross receipts rather than taxes on an individual's net income. Resp. Br. at 20 (citing *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938); *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939); *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653 (1948)). The "control[ling]" force of these three cases eluded the Court of Appeals, which failed to cite any of them, perhaps because two of the cases, *J.D. Adams* and *Central Greyhound Lines*, were not cited in the Wynnes' briefing below, and the third, *Gwin*, made only a one-sentence cameo appearance; none of the cases merited mention in the Wynnes' previous two submissions to this Court.

These cases provide no support for the Wynnes' theory that states lack greater power to impose personal income taxes on their own residents than on nonresidents. The decisions do not purport to address, much less endorse, this heretofore unknown proposition—unsurprisingly, since the Court in each case was analyzing a gross receipts tax assessed on total revenues, not a tax on net income, the type of tax Maryland imposes. This Court's precedents have never confused the two forms of taxes, which operate very differently. *See* Charles Trost, *Federal Limitations on State and Local Taxation* §10:1 (2d ed.). Indeed, *Gwin* itself identified net income taxes

as a permissible alternative revenue measure that avoids the constitutional infirmities of the gross receipts tax the Court invalidated in that case: "There has been left to the states wide scope for taxation of those engaged in interstate commerce, extending to the instruments of that commerce, to *net income* derived from it, and to other forms of taxation not destructive of it." 305 U.S. at 441 (emphasis added). Whatever guidance the Wynnes might try to extract from the line of jurisprudence involving taxes levied upon gross revenues, there is no basis for disregarding the distinction upon which those decisions insisted and extending their holdings to the very different context of net income taxes. These three decisions, evaluating challenges to corporate gross receipts taxes, had no occasion to address, and provide no basis for disturbing, the "well-established principle" that supports a state's broad taxing authority over all of its own residents' income. *Chickasaw Nation*, 515 U.S. at 462-63.

Citing their newfound trilogy of gross-receipts-tax cases, the Wynnes now argue that (1) the Commerce Clause prohibits multiple taxation of interstate commercial transactions, and further prohibits the "risk" of a state's multiple taxation of the personal income of its own residents, *see* Resp. Br. at 14-15; (2) Maryland's tax scheme is constitutionally problematic because it protects C-corporations from multiple taxation but not S-corporations, *see* Resp. Br. at 3-4; and, (3) Maryland's partial-tax-credit scheme substantially burdens commerce engaged in by S-corporations in which Marylanders own shares, *see* Resp. Br. at 11-12.

In urging the Court to disavow its long-standing recognition of a state's plenary taxing power over its own citizens, the Wynnes both undervalue the fundamental nature of this sovereign power and ignore that the income of a C-corporation income, unlike that of an S-corporation, is *always* taxed twice—first, at the entity level and then as income to its shareholders, *see* Br. Multistate Tax Comm'n at 9-10. Having invested in Maxim, an S-corporation whose owners benefit from pass-through tax treatment in Maryland, the Wynnes should not be heard to complain about the supposed burden of paying taxes to states where Maxim operates in addition to the taxes Maryland is entitled to impose on either form of investment income received by its residents.

I. The State's Power to Tax Its Own Residents Is a Deeply Rooted and Fundamental Attribute of Sovereignty.

"The States . . . retain substantial sovereign authority under our constitutional system," *Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991), including "the attribute of sovereign powers in devising their fiscal systems to ensure revenue and foster their local interests," *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 526 (1959). This state power, understood from the time of the framers to be an inherent attribute of sovereignty, "'extend[s] to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the

State.'" *Gregory*, 501 U.S. at 457 (quoting *The Federalist* No. 45 at 292-93 (C. Rossiter ed. 1961)).

Indeed, Alexander Hamilton explained that the states entering the Union would continue to "possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." *The Federalist* No. 32 at 197-98 (C. Rossiter ed. 1961). The essential and fundamental nature of this power "is an incident of sovereignty, and is co-extensive with that to which it is an incident." *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 429 (1819); *see also Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 199 (1824) ("The power of taxation is indispensable to [the states'] existence . . . ."); *The Federalist* No. 33 at 173 (C. Rossiter ed. 1961); *accord Arkansas v. Farm Credit Servs.*, 520 U.S. 821, 826 (1997) ("The power to tax is basic to the power of the State to exist."); *see also Department of Revenue of Or. v. ACF Indus.*, 510 U.S. 332, 345 (1994) (recognizing that "the taxation authority of state government" is "central to state sovereignty").

The foundational nature of these principles makes it highly improbable that the states thought they were surrendering this fundamental aspect of their powers by ratifying constitutional provisions that, on their face, do nothing more than authorize Congress to regulate foreign and interstate commerce. Indeed, in observing that federal powers under the constitution are "few and defined" and assuring that "[t]he powers reserved to the several States will extend to all the objects which . . . concern the lives, liberties, and properties of the people, and the

interna' order, improvement, and prosperity of the State," James Madison tersely dismissed the notion that these powers were threatened by the Commerce Clause: "The regulation of commerce, it is true, is a new power; but that seems to be an addition which few oppose, and from which no apprehensions are entertained." *The Federalist* No. 45 at 293 (C. Rossiter ed. 1961).

The Wynnes and their *amici* undervalue the sovereignty interests embodied in, and advanced by, the well-established principle justifying a state's authority to tax its residents based on their domicile. The taxing power of a government over its citizens is recognized as a deeply-rooted attribute of sovereignty not only in this Court's precedents; it has long had "international acceptance" as a "general princip[e]." *Chickasaw Nation*, 515 U.S. at 463. A state's power to decide how to structure its "fiscal systems" and how to choose among different methods for raising the revenue needed to fund government services is likewise understood to be an inherent power that derives from the states' status as sovereigns within our federalist system. *Allied Stores,* 358 U.S. at 526. For these reasons, this Court has declared that generally "[a] State is free to pursue its own fiscal policies, unembarrassed by the Constitution," and "[n]othing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the States and to inject themselves in a merely negative way into the delicate processes of fiscal policy-making." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 436, 444, 445 (1940).

Thus, the Court has recognized that the judiciary is ill-suited for evaluating a state's fiscal alternatives, *id.* at 445, such as the Wynnes' attempt to minimize the relative importance of the "$45 to $50 million per year . . . at stake in this case," Resp. Br. at 50, and their proposal that Maryland should lean more heavily on regressive property and sales tax measures, contrary to the approach chosen by the General Assembly, *id.* at 50-51. The Wynnes' *amici* misstate the basis for the choices that Maryland made through the "delicate processes of fiscal policy-making," *J.C. Penney*, 311 U.S. at 445, by mischaracterizing the legislative history and purpose behind Maryland's County tax, *see, e.g.*, Tax Exec. Inst. Br. at 17; Am. Ass'n of Att'y-CPAs Br. at 3 n.4; Tax Economists Br. at 6, 7, 15; id. at 27-31) (claiming the 1975 amendments had purpose of discriminating against interstate commerce). Far from being motivated by some discriminatory or invidious purpose, the County tax was enacted after extensive deliberation as part of a comprehensive set of fiscal reforms intended to allocate tax burdens more equitably among the State's residents, to reduce the State's reliance on regressive methods of taxation, and to provide greater budgetary stability for the State's local governments.

The effort began in 1962 when the General Assembly created a commission to examine the State's tax system. Md. Joint Resolution No. 1 (1962). That commission recommended "sweeping changes in State and local taxes" in its 1965 report; the same year, the General Assembly appointed a special legislative commission to study possible

revisions to the tax code. Md. Joint Resolution No. 11 (1965); Preliminary Report of the Special Legislative Commission on State and Local Taxation and Financial Relations, at i (Oct. 1965).

The special legislative commission concluded that, although "[l]ocal governments provide the strength of our State and Nation," they have been "unable to provide for the legitimate needs of their people through present resources." Final Report of the Special Legislative Commission on State and Local Taxation and Financial Relations at 1 (Jan. 7, 1966). The report cautioned, however, against relying on increased property taxes as a source of additional revenue because of the regressive effects of such taxes. *See id.* at 3. The commission advised that "it is offensive to our inherent sense of fair play to require those with the least income to pay a larger percentage of that income for taxes than those with greater income" and that, instead, "tax burdens" should be "fair," "equitable," and "bear a reasonable relationship to ability to pay." *Id.* at 1, 2. Because "taxes upon income are the only ones capable of progressivity," the report recommended that the State rely more heavily on income taxes and shift from a flat income tax rate to a progressive, graduated rate schedule. *See id.* at 3-4. Although a tax reform bill based on these recommendations failed during the 1966 legislative session, the Legislature met in special session to enact a temporary measure authorizing local jurisdictions to impose their own income taxes. 1966 Md. Laws Spec. Sess., ch. 2.

Later that year, the Governor-elect appointed another committee to review the State's tax system and recommend new legislation. *See* Report of the Committee on Taxation and Fiscal Reform: A Program to Meet Maryland's Fiscal Problems in 1968 (Feb. 1, 1967). This committee also recommended that the State "move to correct the regressive nature of its total tax structure" and that "the only effective means of improving our situation is to shift the burden from property taxation to taxation of income on a graduated basis." *Id.* at 2. In particular, with respect to local governments, the committee concluded that property taxes "cannot continue to carry the bulk of the burden of local government" because they are "the most regressive of all taxes." *Id.* at 1. "If local governments are to continue to carry their present share of responsibility for providing services," the committee explained, "then local governments must be given other sources through which they can tax the wealth of their citizens equitably." *Id.* The committee therefore recommended, among other things, that (1) the State shift to a graduated income tax and (2) each county be required to impose an additional income tax levy on top of the State's new graduated income tax. *Id.* at 7-8. The General Assembly implemented these recommendations in 1967 through an omnibus tax reform bill. 1967 Md. Laws, ch. 142.

The local income tax, therefore, was part of a multi-year comprehensive effort by Maryland's policymakers to distribute the burdens of local government more equitably among State residents based on their ability to pay and these reforms

quickly had the desired effect of decreasing the State's reliance on regressive forms of taxation. By 1971, Maryland had "raise[d] two and a half times as large a percentage of [its] revenues from the income tax as the average of state and local governments in the country." Report of the Study Commission on the State Tax Structure at 9-11 (Jan. 4, 1971). According to a later report—based primarily on data from the 1973 tax year—property taxes in Maryland declined as a percentage of total local government revenues, in some cases dramatically, because of the new local income tax. *See* 1975 Report of the State Tax Reform Study Committee at 4 (Feb. 23, 1976); Technical Supplement to the 1975 Report of the State Tax Reform Study Committee at 21 (Feb. 23, 1976).

In 1974, a decision by the Maryland Court of Appeals altered the way the County tax had been administered by sustaining a taxpayer's challenge to the tax scheme and holding that the statutory credit for taxes paid to another state extended to the county component of the tax. *Stern v. Comptroller*, 271 Md. 310 (1974). This holding interfered with the balance struck by the General Assembly in two ways. First, as the Court of Appeals later recognized, "permitting Maryland residents to deduct credits from county income taxes in the amount of income taxes paid to other states" would lead to certain taxpayers "paying little or no local tax for the services provided by the county while a neighbor with similar income, exemptions, and deductions might be paying a substantial local tax to support those services." *Frey v. Comptroller*, 422 Md. 111, 140 (2011) (quoting *Blanton v. Comptroller*, 390 Md. 528, 536 n.9 (2006)).

Second, the ruling in *Stern* decreased the revenue that local jurisdictions could raise through income taxes—the means of taxation that the General Assembly had selected when it overhauled the tax system in 1967 to make it less regressive.

The legislative history therefore offers no support for the claim that the 1975 change was animated by a discriminatory purpose. On the contrary, the Maryland Legislature simply acted to clarify that County income taxes could not be reduced by the credit for taxes paid to another jurisdiction.[1] 1975 Md. Laws, ch. 3. There is no evidence that, in doing so, the General Assembly intended to erect protectionist barriers to interstate commerce or to deter its residents from participating in interstate commerce. Rather, the Legislature's goals—as they

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[1] Prior to the Court of Appeals' decision in *Stern*, the administrative construction by the Comptroller and the Maryland Tax Court was that the credit did not apply to the County tax. As the Tax Court explained in *Scott v. Comptroller*, Income T[illegible] 198, 1970 WL 582 (Md. Tax Oct. 13, 1970), the credit provision "was enacted in 1939 and ha[d] not been changed since that time . . . . Such being the case, the Legislature could only have intended in 1939 that the tax credit then provided for be deducted from the resident's state income tax, since there was no county income tax in Maryland at that time." The Comptroller defended his administration of the tax on these grounds. Brief of Appellee at 3, *Stern v. Comptroller*, 271 Md. 310 (1974). If the Comptroller had believed that the Legislature intended the credit to apply, the *Stern* case would not have arisen. Thus, it does not appear that the credit provision was ever understood to apply to the County tax until *Stern*, and, in overturning the Court of Appeals' ruling, the General Assembly was simply restoring that original understanding.

were throughout this whole period—were to ensure the equitable distribution of the State's tax burden among its own residents and ensure that local jurisdictions would have sufficient resources to provide the necessary services to those residents. Indeed, future study committees appointed by the General Assembly continued to view the "innovation" of Maryland's local income tax as an integral piece of that endeavor. *See, e.g.*, 1975 Report of the State Tax Reform Study Committee at 3 (explaining that the County tax was a "major contributing factor" in Maryland's decreased reliance on regressive property taxes).

Maryland's County tax, therefore, has its roots in careful policy judgments by elected officials about how to fairly and equitably distribute the burden of taxation among Maryland residents. These policy judgments are best left to the states in the exercise of their sovereign power to craft their own tax systems.

II. A Requirement for Mandatory Apportionment Is Incompatible with a State's Power to Tax Its Residents' Entire Income.

The Wynnes no longer advance any argument responsive to the predominant concern of dormant Commerce Clause jurisprudence, which is deterring discrimination resulting from protectionist state laws. *See Department of Revenue v. Davis*, 553 U.S. 328, 337 (2008) ("[T]he dormant Commerce Clause is driven by concern about economic protectionism[.]"). Their brief in this Court does not attempt to defend the Court of Appeals' finding of such discrimination.

The Wynnes evidently have accepted the reality that Maryland's tax treats in-state and out-of-state income exactly the same (and then offers a credit for out-of-state taxes that effectively results in higher taxes on in-state income). Instead, the Wynnes now limit their "discrimination" argument to a conflation of prongs two and three of the *Complete Auto* test, *see Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977); that is, they effectively contend that absent a full credit for out-of-state taxes, Maryland's County tax "discriminates against interstate commerce" solely because, in their view, it "is not fairly apportioned." Resp. Br. at 23. Their malapportionment argument lacks merit on its own, and it fares no better when it is collapsed into their discrimination claim.

Although the Wynnes "agree" that "Maryland has the sovereign power to tax all its residents' income, wherever earned," Resp. Br. at 11; *id.* at 27-28 (same), they insist that Maryland is prevented from *exercising* this sovereign power on any of their income earned outside the State. Exercising that power, they contend, creates a "risk" that such income may be "double taxed" by another state, "regardless of whether other States actually exercise their jurisdiction to tax the Wynnes' income earned within their borders," *id.* at 35-36. Thus, their argument in favor of apportionment is internally contradictory. In the Wynnes' view, Maryland possesses a comprehensive sovereign power to tax its residents' income that the State nonetheless cannot exercise in light of the ever-present "risk" of taxation by other states, and the Wynnes enjoy the privileges

of residence in Maryland, but cannot be asked to pay an income tax measured in accordance with these privileges. Nothing in the Constitution or this Court's precedent can be deemed to impose such a paradoxical arrangement that would effectively negate an essential "attribute of sovereign powers" inherent in statehood itself. *Allied Stores*, 358 U.S. at 526.

The Wynnes' argument ultimately rests on a single proposition, namely, that the Constitution requires a state to "apportion" its tax on residents to exclude income that is potentially subject to taxation by other states. They contend that the only power a state may exercise in taxing personal income is the state's "source-based" authority to "tax commerce conducted within its borders," Resp. Br. at 38, not in the broader power to tax on the basis of "domicile" that this Court has repeatedly recognized. The Wynnes concede a state's power to tax beyond borders on domicile basis, Resp. Br. at 11, 27-28, but then insist that Commerce Clause-mandated apportionment limits the domiciliary state's authority to tax a resident's personal income to income from sources within its own territory. It makes no sense, however, that the foundational principle of the sovereign power to tax *all* of a resident's income, wherever sourced, is limited by an apportionment rule that restricts the taxing authority to income from sources or activities within the state. The principle that a state has sovereign power to tax out-of-state necessarily means that its taxing power need not be restricted to income within its borders. The Wynne's argument cannot be

squared with this Court's precedents concerning a state's power of taxation with respect to its own residents for, as the Court has explained, a state's power to tax on the basis of domicile is justified by the unique relationship between a state and its residents. *See, e.g., New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937) ("The [power to] tax . . . is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state."); *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 280-81 (1932). Those precedents concerning the "domicile" basis for taxation do more than merely acknowledge the power's existence and its character as an attribute of sovereignty; they endorse a state's exercise of that power and reject the suggestion that the power is lost when another state legitimately exercises its power to tax the same object on a basis other than the taxpayer's domicile. *See Chickasaw Nation*, 515 U.S. at 463 n.12; *State Tax Comm'n of Utah v. Aldrich*, 316 U.S. 174, 176-77 (1942); *Curry v. McCanless*, 307 U.S. 357, 368 (1939); *Guaranty Trust Co. of New York v. Va.*, 305 U.S. 19, 23 (1938).

Just as deeply entrenched as the states' sovereign power to tax is the understanding that unique privileges and obligations attach to the relationship between a state and its own residents, particularly in a democracy, where it is the residents who ultimately direct the state's exercise of its sovereign powers. *See McCulloch*, 17 U.S. at 428. It is precisely this relationship that undergirds the domicile-based

taxing power, based on the benefits that states provide to their own citizens, and the concomitant expectation that those citizens will support their government by the payment of taxes.

The Wynnes' argument assumes that these foundational principles have no place in dormant Commerce Clause jurisprudence, but this Court's precedent disagrees. Contrary to the Wynnes' assertion that "this Court's cases have never suggested" that the "host of financial benefits" that states "provide their residents" is "a good enough reason to burden interstate commerce," Resp. Br. at 48-49, the very first case cited in their brief instructs that the "broad inquiry" that applies to state taxing powers under *both* the Due Process Clause *and* the Commerce Clause asks "'whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state'—that is, 'whether the state has given anything for which it can ask return.'" *MeadWestvaco Co. ex rel. Mead Corp. v. Illinois Dep't of Revenue*, 553 U.S. 16, 24-25 (2008) (quoting *J.C. Penney*, 311 U. S. at 444). When the state imposing the income tax is the state of residence, the answer to that inquiry, under either clause of the Constitution, is inevitably an undeniable "yes."

The Wynnes' theory is thus wholly unsupported. When all is said and done, they do not cite a single case—under the Due Process Clause, the Commerce Clause, or any other doctrine—holding that a state must apportion the tax base where, as here, the state's sovereign power authorizes it to tax the object

in its entirety. The Wynnes do no more than show that a state must apportion taxes to avoid taxing values beyond its lawful jurisdiction, an undisputed point that has no relevance here, where a state's jurisdiction to tax its own residents' income lawfully extends to "all" of their income, "even income earned outside the taxing jurisdiction." *Chickasaw Nation*, 515 U.S. at 462-63.

Finally, the authority that the Wynnes now wrongly cite as dispositive does not govern in this context. Resp. Br. at 17-18. Those three cases, *J.D. Adams*, *Gwin*, and *Central Greyhound Lines*, involve gross receipts taxes on out-of-state activities of corporations. These precedents are wholly inapposite because they involve neither resident individuals nor net income taxes but, rather, corporations in interstate commerce that challenged states' overreaching in imposing gross receipts taxes on the out-of-state activities of a unitary business. *See Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 439 (1980) ("As these cases indicate, the linchpin of apportionability in the field of state income taxation is the unitary-business principle."). This Court's precedents expressly distinguish between these two forms of taxes, precisely on the ground that some gross receipts taxes are structured so that they impermissibly tax values beyond the taxing state's jurisdiction, whereas net income taxes do not present the same concern. *See Gwin*, 305 U.S. at 441. Moreover, this Court has rejected similar "reference[s] to unconstitutional 'burdens' on interstate commerce made in general statements . . . torn from their setting in judicial

opinions" and that "speak of state . . . taxes of a different kind" than that before the Court. *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 50 (1940). That is what the Wynnes do here, and their reliance on inapposite corporate gross receipts tax cases should likewise be rejected.

III. Compelling Maryland to Allow a Credit Against County Taxes Would Interfere with the State's Sovereign Prerogative to Allocate Tax Burdens More Equitably Among the State's Residents and Would Be Unworkable.

Under the Wynnes' proposal, individual resident Maryland taxpayers would pay property taxes on property they own within Maryland's borders; they would pay sales taxes on purchases they make within Maryland's borders; and they would pay income taxes on money earned from activities or derived from sources within Maryland. *See* Resp. Br. at 49. Maryland's resident taxpayers would not, however, be responsible for paying individual resident income taxes to Maryland or its local governments on income they receive from sources or activities outside Maryland's territorial borders.

In the Wynnes' view, their proposal is a modest one, and Maryland should be content to restructure its fiscal system to comport with their vision of what the Constitution requires and to make up for the revenue that would be lost under their proposal. The proposed arrangement is both familiar and strange. It is familiar because it describes precisely the tax obligations that a state may constitutionally impose

on nonresidents; it is strange because it takes no account of the unique privileges enjoyed by residents. Under present law, nonresidents already pay those same property, sales, and income taxes that the Wynnes are willing to pay, on the same objects of taxation. Nonresidents also receive the exemption from Maryland personal income taxes to which the Wynnes claim a constitutional entitlement. That is, Maryland does not tax nonresidents on income earned from activities or derived from sources outside Maryland.

But nonresidents, unlike the Wynnes, are not eligible to receive the many benefits and services that Maryland and its local governments provide exclusively to residents. *See* Pet'r Br. at 20-23. Of course, as the Wynnes observe, many other state and local government services are not restricted to residents. But, unlike the Wynnes, nonresidents have no say in the democratic process that determines which services Maryland or Howard County will provide, the amount or quality of those services, or the way they will be delivered. The Wynnes' demand to have their income taxed only on a "source" basis (and thus to pay less for the privileges of residence than neighbors who happen to earn their income in Maryland) denies what this Court's precedents affirm: that "[e]njoyment of the privileges of residence . . . are inseparable from the responsibility for sharing the costs of government," *Lawrence*, 286 U.S. at 279, and that "[a] tax measured by the net income of residents is an equitable method of distributing the burdens of

government among those who are privileged to enjoy its benefits," *New York ex rel. Cohn*, 300 U.S. at 313.

If the Wynnes are correct that a state of residence may tax its residents only on a source basis, then no state's credit scheme cures the constitutional violation they perceive. Every credit statute contains limitations, the most common of which operate to allow the state of residence to collect taxes on income from sources in another state if that state does not have an income tax or taxes the income at a rate lower than the residence state. *See* Hellerstein, *State Taxation* ¶ 20.10 (3d ed. 2013) (hereinafter Hellerstein). The Wynnes' proposed rule is also impractical, because it will cause significant disruption to existing state tax regimes. Indeed, if this Court holds that a full credit is compelled by the Commerce Clause—and thereby constitutionalizes this entire area of the law—lower courts will inevitably and with far greater frequency be called upon to do what this Court has historically sought to avoid, by "inject[ing] themselves" into the various states' "delicate," and idiosyncratic, "processes of fiscal policy-making." *J.C. Penney*, 311 U.S. at 445. Such delving into the minutiae of state tax policies would become necessary, in a case such as this, because states often do not grant a completely full credit for all taxes paid to other states. Rather, to name just a few examples, states often limit their credits to when the tax paid to the other state was similar in nature, was paid during the same tax year, or was properly based only on sources of income attributable to activity in the other state. *See* Hellerstein ¶ 20.10. Under the Wynnes' proposed

rule, states will likely face Commerce Clause challenges to these restrictions, and courts will ultimately have to resolve whether these partial credits are also constitutionally prohibited.

For example, under the current regime, questions frequently arise about whether a particular out-of-state tax is an "income" tax to which a credit should apply. *See, e.g., Herschend v. Director of Revenue*, 896 S.W.2d 458 (Mo. 1995) (whether an excise tax on a S-corporation was an income tax); *King v. Forst*, 391 S.E.2d 60 (Va. 1990) (whether an unincorporated business tax was an income tax); *see also PPL Corp. v. Comm'r*, 133 S. Ct. 1897 (2013) (facing similar question with respect to federal government's credit for taxes paid to foreign nations). Some states impose even stricter limits, by granting a credit only to net income taxes or "substantially similar" taxes paid to other states. *E.g.*, Ariz. Rev. Stat. §43-1071; Cal. Rev. & Tax Code §18001; Va. Code §58.1-332.2(C). The legality of these restrictions will become federal constitutional questions if the Wynnes prevail.

Similarly, taxpayers may be faced with "double taxation" when their home state allows a credit only for taxes paid during the same tax year, particularly when the relevant income is deferred for tax purposes in one state but not the other. *See* Hellerstein ¶ 20.10 n.742. Some state courts, in fact, have denied credits for taxes paid to other states on these grounds. *E.g., Idaho Tax Comm'n v. Stang*, 25 P.3d 113, 115-16 (Idaho 2001) (denying credit on contributions to IRA in earlier tax year); *Estate of*

Guzzardi v. Director, Div. of Taxation, 15 N.J. Tax 395, , 405-09 (1995), *aff'd per curiam*, 16 N.J. Tax 374 (N.J. Sup. Ct. App. Div. 1996) (denying credit against New Jersey tax imposed on installment sale gain for taxes paid to another state during a prior year on same gain because other state did not recognize installment method of reporting). If this Court accepts the Wynnes' rule, these restrictions might also be subject to challenge under the Commerce Clause.

Finally, most states also limit their credits for taxes paid to other states to those taxes that were attributable to out-of-state activities—that is, based on the other state's properly exercised "source" jurisdiction. *See, e.g.*, Ark. Code Ann. § 26-51-504(a)(1); Colo. Rev. Stat. Ann. § 39-22-108; Del. Code Ann. tit. 30, § 1111(a); Me. Rev. Stat. Ann. tit. 36, § 5217-A; Mo. Ann. Stat. § 143.081; W. Va. Code § 11-21-20(a). These statutes, however, cause "a substantial risk of multiple taxation" when "the resident's state defines the source of income differently from the way it is defined by states that tax the income on a source basis." Hellerstein ¶ 20.10[2][b] (internal quotation marks omitted).

In constitutionalizing this area of the law, this Court would make it a constitutional battleground and, more significantly, would for the first time take these important legislative policy questions out of the states' hands. The Court has never before decided that it should interfere in states' choices about how to tax their own residents, and there is no reason for the Court to do so here.

CONCLUSION

The judgment of the Court of Appeals of Maryland should be reversed.

Respectfully submitted,

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October 2014

SUPPLEMENTAL BRIEF

RECORD
AND
BRIEFS

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No. 13-485

IN THE
Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Petition for a Writ of Certiorari to the Maryland Court of Appeals

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IN THE

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No. 13-485

MARYLAND STATE COMPTROLLER OF THE TREASURY,
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On Petition for a Writ of Certiorari to the Maryland Court of Appeals

SUPPLEMENTAL BRIEF FOR RESPONDENTS

INTRODUCTION

The United States' recommendation that the Court grant the petition is curious, to say the least, since everything it has to say about the petition's certworthiness cuts the other way. The United States tacitly concedes that the case is important to Maryland alone. U.S. Br. 18. It concedes that the decision below does not conflict with any holding of this Court or any state high court. *Id.* at 18-21. It concedes that the decision's impact on other jurisdictions is uncertain at best. *Id.* at 19. And while it asserts that "more than 2000 municipal income taxes" may be called into question by the logic of the ruling below, *id.*, that math is wrong: The vast majority of those taxes are irrelevant because they do not double-tax. This Court does not typically grant certiora-

ri when none of its traditional criteria are satisfied. It should not do so here.

Lacking anything convincing to say about certworthiness, the United States leads with a long merits discussion. U.S. Br. 7-18. Its argument is unsound. The United States relies on *due process* cases to argue that states' income taxes on their residents cannot run afoul of the *Commerce Clause*—a mix-and-match approach this Court has criticized before. It offers an analysis of *Complete Auto* that bears no resemblance to how this Court has applied that case. And, most startling of all, it advances a rule that would give corporations far stronger protections under the Commerce Clause than individuals engaged in interstate business.

The United States' dubious merits analysis only underscores the wisdom of allowing the question presented to percolate—something that, thus far, has not happened in even one other state. The petition should be denied.

ARGUMENT

I. THE UNITED STATES CONCEDES THAT THE DECISION BELOW DOES NOT MEET THIS COURT'S CERTIORARI CRITERIA.

1. The United States' lead rationale for a grant is that "the court below resolved a question of exceptional importance *to Maryland*." U.S. Br. 18 (emphasis added). The last two words give away the game. This Court grants the writ in cases "involving principles the settlement of which is of importance to the public as distinguished from that of the parties." *Layne & Bowler Corp.* v. *Western Well Works, Inc.*, 261 U.S. 387, 393 (1923). Whatever the importance of this case to Maryland, its application to the rest of

the nation is questionable at best. *Infra* at 3-6. Moreover, Maryland has a court dedicated to resolving questions of exceptional importance to Maryland: the Maryland Court of Appeals. That tribunal has spoken. Its decision does not warrant further review.

The United States emphasizes that the decision below will impact Maryland's coffers. U.S. Br. 18. But "[t]he amount of money involved" in a case "is not usually thought to be controlling unless it is enormous." S. Shapiro *et al.*, *Supreme Court Practice* § 6.31(b), p. 480 (10th ed. 2013). If this Court were to take every case involving—at most—$170 million (U.S. Br. 18), its discretionary docket would soon be overwhelmed.

Besides, the $120 million in refunds the United States cites is the result of Maryland's own statutory three-year window for reopening filed returns and 13% interest rate for income-tax refunds and deficiencies. Md. Code, Tax-Gen. §§ 13-1104(c), 13-604(b)(1); BIO 24-25. Those statutes make the Comptroller a "net winner," in his words, by permitting him to recover past delinquencies at a significant premium. Maryland House, Ways & Means Committee Hearing, at 11:09-11:20 (Jan. 16, 2014).[1] That they happen to cut the other way here hardly converts this into a certworthy case.

2. The United States is studiously agnostic about the decision's impact beyond Maryland. The most it can manage: the decision "*appears* to have im-

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[1] *Available at* http://mgahouse.maryland.gov/house/play/bb27a73d-ed8f-4474-b6e4-c5b9cc9c7acf/?catalog/03e481c7-8a42-4438-a7da-93ff74bdaa4c.

portance" outside the state's borders. U.S. Br. 19 (emphasis added). But the United States does not cite a single imperiled local tax. Instead—relying solely on the briefs—it tentatively concludes that there are "more than 2000 municipal income taxes nationwide that *might not* provide credits[.]" *Id.* (emphasis added). In a brief that was supposed to provide the United States' expert view, the Solicitor General has punted.

That reticence is particularly puzzling because although some of those 2,000 local taxes may not provide a *credit* for out-of-state income taxes, they avoid infirmity in other ways:

- Kansas' 535 local income taxes apply only to "intangibles such as interest, dividends, and securities transactions[.]" J. Henchman & J. Sapia, *Tax Foundation Fiscal Fact No. 280*, at 7 (2011).[2] Unlike income taxes on interstate business income, taxes on intangible investment income are not necessarily subject to apportionment under the dormant Commerce Clause. BIO 19.
- Kentucky's 218 local income taxes are distinguishable because they do not treat S Corporations as pass-through entities. Instead, they tax the S Corporation on a formula-apportionment basis, which avoids double taxation. *See, e.g.*, City of Adairville, Ky., Ordinances § 110.04(F)[3];

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[2] *Available at* http://taxfoundation.org/sites/taxfoundation.org/files/ docs/ff280.pdf.

[3] *Available at* http://app.sos.ky.gov/occupationaltax/images/8-16.pdf.

Ky. Rev. Stat. § 67.753. Distributions from the S Corporation to shareholders, meanwhile, are not taxed by the locality at all. *See, e.g.*, City of Berea, Ky., Occupational License Tax Instruction Form.[4]

- Iowa's 297 local income "surtaxes" are not measured by the taxpayer's income, but rather the taxpayer's state income-tax obligation. Iowa Code § 257.21. And because an Iowa resident's state income-tax obligation already includes a credit for taxes paid to other states, *id.* § 422.8, so does the surtax.
- Most of Ohio's 774 local income taxes avoid double taxation because they tax the S Corporation on a formula-apportionment basis. Distributions passed through to the shareholder are then excluded from the shareholder's locally taxable income. *See* Ohio Rev. Code § 718.01(9)(a); OAR Daily Buzz, *Experts Highlight Key Provisions of Ohio's Municipal Income Tax Reform Package* (Nov. 14, 2013).[5]

Of the 2,000 supposedly imperiled taxes, then, *over 1,700* are not implicated by the decision below. Respondents provided this information to the Solicitor General, but the United States' brief does not engage with it. Its failure to do so calls into question the soundness of its views.

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[4] *Available at* http://app.sos.ky.gov/occupationaltax/images/13-29.pdf.

[5] *Available at* http://ohiorealtors.org/2013/11/14/experts-highlight-keyprovisions-of-ohios-municipal-income-tax-reform-package/.

3. Even as to the few local taxes that may (or may not) be suspect under the Court of Appeals' reasoning, the United States admits the outcome is speculative. Such taxes, it says, "*could* be invalidated *if* courts in the relevant jurisdictions find the reasoning of the decision below persuasive." U.S. Br. 19-20 (emphases added). That uncertainty is an argument for percolation, not review.

Indeed, the United States concedes that the decision below does not conflict with any decision of this Court or any state high court: It confesses that we are "correct[]" that the Comptroller's cited Supreme Court decisions "addressed challenges brought under the Due Process Clause, rather than under the Commerce Clause." U.S. Br. 10. It admits that the Comptroller's cited state-court decisions did not address "identical" issues. *Id.* at 20. And it does not disagree with our argument (BIO 18-21) that if the Wynnes lived in the states whose decisions the Comptroller cites, they would not have been double-taxed.

In similar circumstances, the United States has counseled this Court to deny the writ. *See, e.g.*, Br. for Federal Respondents, *Pacific Gas & Elec. Co.* v. *San Luis Obispo Mothers for Peace*, No. 06-466, 2006 WL 3740624, *6 (Dec. 15, 2006) (disagreeing with decision below but recommending denial because "there is no square circuit conflict"). Its only reason to deviate from that course here is the supposed "uncertainty created by the decision below, together with the *possibility* that similar tax schemes *might* be deemed constitutional in some jurisdictions but not others." U.S. Br. 20 (emphases added). That the United States must qualify its sentence so heavily refutes its own argument.

4. In the end, this Court is faced with a nascent legal principle, a question presented that was not pressed or passed upon below, *see* BIO 10-13, and a state-court decision with conjectural national impact. That is a recipe for denial.

II. THE DECISION BELOW IS CORRECT.

1. On the merits, this case is governed by three bedrock principles. First, the dormant Commerce Clause imposes a "prohibition against multiple taxation" of the same value by two or more states. *Oklahoma Tax Comm'n* v. *Jefferson Lines, Inc.*, 514 U.S. 175, 182 (1995). Second, the Court "has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 446-447 (1979). Third, the Court has held that "[t]he rule which permits taxation by two or more states on an apportionment basis precludes taxation of all the property *by the state of domicile.*" *Standard Oil Co.* v. *Peck*, 342 U.S. 382, 384 (1952) (emphasis added). Taken together, these rules confirm that the decision below was correct. Because other states exercised their due-process power to tax a portion of the Wynnes' income, Pet. App. 9a, Maryland was precluded from taxing their income in full.

The United States insists these settled principles are inapplicable because the case involves income. U.S. Br. 8 n.1. But the case it cites—*Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159 (1983)—only confirms the infirmity of Maryland's partial-credit scheme. *Container Corp.* held that the income tax at issue was constitutional because it did not necessarily double-tax. Any double taxation was simply the

result of two jurisdictions' different apportionment formulas. *Id.* at 184-185, 188. It contrasted that result with *Japan Line*, where "one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part—a combination resulting necessarily in double taxation." *Id.* at 188. This case is like *Japan Line*: Maryland claims the right to tax the Wynnes' income in full, whereas other jurisdictions claim the right to tax the same income in part—"a combination resulting necessarily in double taxation." *Id.*; *see* Pet. App. 22a.

The United States also suggests the Wynnes can be double-taxed as much as Maryland pleases because they are natural persons, not corporations. U.S. Br. 16 n.2. As the government sees things, the dormant Commerce Clause forbids double taxation of a *corporation's* interstate income by its state of domicile, but *individuals* are not entitled to the same protection. *Id.* That assertion is startling: We are aware of no case holding that corporations enjoy greater constitutional rights than human beings.

The United States' corporations-are-different argument also fails on its own terms. The interstate income at issue here *is* corporate income—it is Maxim's income, imputed to the Wynnes by Maxim's S-Corporation election and Maryland's tax statutes. Pet. App. 7a-9a; 26 U.S.C § 1366. Moreover, a corporation *does* have a special relationship with its state of domicile. Legally, a corporation is "at home" in its domiciliary state and is subject to the state's pervasive general jurisdiction. *Daimler AG* v. *Bauman*, 134 S. Ct. 746, 758 n.11 (2014). And economically, a corporation often draws robustly on local services in its state of domicile. Yet, according to the United

States, corporations cannot be double-taxed whereas the Wynnes can. That result has no basis in logic or law.

2. Instead of examining this Court's dormant Commerce Clause precedents, the United States relies on what it admits are solely due-process cases. U.S. Br. 7-11. It justifies this sleight-of-hand by arguing that the dormant Commerce Clause holding below "would effectively nullify" those cases' due-process holdings. *Id.* at 11.

Not so. We do not know whether the domiciliary states in the United States' cases allowed a credit, precisely because the cases did not focus on that aspect. But even those states did not, their taxes' infirmity under the dormant Commerce Clause simply demonstrates a different principle: "A tax may be consistent with due process and yet unduly burden interstate commerce." *Quill Corp.* v. *North Dakota*, 504 U.S. 298, 313 n.7 (1992). The United States' brief ignores that teaching.

The United States also leans on a solitary footnote from *Oklahoma Tax Commission* v. *Chickasaw Nation*, 515 U.S. 450, 463 n.12 (1995). U.S. Br. 9, 18-19. As we have explained before, that footnote cannot be read as the United States reads it; the footnote refers to a state's policy discretion to forgo some of its due-process authority, not the dormant Commerce Clause's prohibition against double taxation. BIO 15.

3. When the United States finally turns to the dormant Commerce Clause, it argues that Maryland's partial-credit scheme satisfies this Court's test from *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977). U.S. Br. 12-18. The United States thus

parts company with the Comptroller, who has abandoned the pretense that Maryland's scheme can survive *Complete Auto*. BIO 9-10.

And for good reason: Maryland's scheme is doubly invalid under that test. First, under *Complete Auto*, a tax must be "fairly apportioned." 430 U.S. at 279. Fair apportionment requires a state's taxing scheme to be—among other things—"internally consistent," *i.e.*, "if applied by every jurisdiction, it would result in no more than all of the [taxpayer's] income being taxed." *Container Corp.*, 463 U.S. at 169. Maryland's partial-credit scheme is not internally consistent because if every state had an income tax identical to Maryland's, resident taxpayers would be subject to substantial double taxation. Pet. App. 18a-25a.

The United States avoids this result by simply declining to conduct the internal-consistency analysis—even while claiming it has done so. U.S. Br. 15-18. Its supposed *Complete Auto* analysis is nothing more than an argument that *Complete Auto* does not apply.

Second, Maryland's tax scheme impermissibly discriminates against interstate commerce. *Complete Auto*, 430 U.S. at 287. By singling out interstate commerce for double taxation, Maryland "exert[s] a pressure on" investors in interstate businesses like the Wynnes "to conduct more of [their] activities in" Maryland. *Amerada Hess Corp.* v. *Director, Div. of Tax.*, 490 U.S. 66, 77-78 (1989); Pet. App. 28a-32a. That is the very discriminatory incentive the dormant Commerce Clause forbids. *See Fulton Corp.* v. *Faulkner*, 516 U.S. 325, 333 (1996).

The United States' contrary analysis is misguided. To hear the government tell it, the Wynnes' claim is that the Maryland law is discriminatory because the Wynnes pay more taxes than couples who do business entirely within Maryland. *See* U.S. Br. 13-15. But that is *not* the Wynnes' claim; they will pay higher taxes whenever a state where Maxim does business applies a higher tax rate than Maryland does, and there is nothing wrong with that. Maryland's scheme is discriminatory for an entirely different reason: The Wynnes *are double-taxed on a portion of their income* and similarly situated Marylanders who earn income entirely in-state are not. Pet. App. 28a-32a.

Moorman Manufacturing Co. v. *Bair*, 437 U.S. 267 (1978), which the United States cites, is not on point. In *Moorman*, as in *Container Corp.*, double taxation resulted because two states' apportionment formulae inadvertently overlapped. *Id.* at 278-280. Here, Maryland made a *deliberate choice* to deny its citizens a credit on out-of-state income. BIO 6. And that is what the Commerce Clause "forbids the States to" do: levy taxes that subject interstate commercial activities to multiple taxation. *MeadWestvaco Corp. ex rel. Mead Corp.* v. *Illinois Dep't of Revenue*, 553 U.S. 16, 24 (2008).

4. Out of doctrinal answers, the United States summons up phantom fears. It says the Court of Appeals' rule unfairly subjects states' tax revenue to the caprice of other states' tax rates. U.S. Br. 9-10. But all states—including Maryland—already face that uncertainty in affording their citizens a credit. BIO 25-26. The sky has not fallen.

Similarly, the United States worries that the decision below will lead to the Wynnes paying nothing for county services. U.S. Br. 9-10. But even with credits, the Wynnes paid over $50,000 in Howard County income taxes due to Maxim's Maryland income and Brian Wynne's salary as Maxim's president. Wynnes' C.A. Br. 46 n.17. Nationwide, moreover, local services are generally funded by property taxes and other local levies, not income taxes. *See* M. Dixon, *Public Education Finances: 2011*, tbl.4 (May 2013)[6]; FEMA, *Funding Alternatives For Fire & Emergency Services* 2-1.[7] Indeed, nine states—including such populous states as Florida and Texas—provide services without imposing *any* income tax. *See* L. Stone, *State Personal Income Tax Rates and Brackets 2014 Update* 1 (Mar. 2014).[8]

But even if the Court of Appeals' decision imposed some hardship on Maryland, the United States' rule would be far worse. Under that regime, no state need provide *any* credit for taxes their residents pay to other states. States may double-tax all they wish.

For residents who commute across state lines, like those in the United States' example (Br. 9), and for shareholders of pass-through entities, the financial impact would be tremendous. The resident would pay *twice* the income taxes, simply for the privilege of working across state lines or owning a business

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[6] *Available at* http://www2.census.gov/govs/school/11f33pub.pdf.

[7] *Available at* http://www.iaff.org/grants/FundingforFireandEMS.pdf.

[8] *Available at* http://taxfoundation.org/sites/taxfoundation.org/files/docs/FF422%20%20State%20Income%20Tax%20Rates%20and%20Brackets.pdf.

that does so. That would make any rational resident decide to seek employment solely in-state, or to avoid investing in interstate partnerships and S Corporations. And that, in turn, creates economic Balkanization offensive to the "national 'common market' " the Commerce Clause protects. *Hunt* v. *Washington State Apple Advertising Comm'n*, 432 U.S. 333, 350 (1977).

The United States suggests this outcome is palatable because states are politically accountable to their residents. U.S. Br. 9, 17-18. But that misunderstands the dormant Commerce Clause's breadth. " 'To carry on interstate commerce is not a franchise or privilege granted by the State; it is a right which every citizen of the United States is entitled to exercise[.]' " *Dennis* v. *Higgins*, 498 U.S. 439, 448 (1991) (citation omitted). Moreover, the clause is "informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." *Quill Corp.*, 504 U.S. at 312. It is the nation as a whole that suffers when states inhibit the mobility of their citizens and their capital.

CONCLUSION

The petition should be denied.

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AMICUS CURIAE BRIEF

No. 13-485

In the Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
PETITIONER

v.

BRIAN WYNNE, ET UX.

ON WRIT OF CERTIORARI
TO THE COURT OF APPEALS OF MARYLAND

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

The State of Maryland funds county-level services in part through taxes on the income of each county's residents. The question presented is as follows:

Whether the Commerce Clause entitles Maryland residents to reduce or eliminate their residential county income-tax obligation based on their payment of income taxes to other States in which they do not reside.

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In the Supreme Court of the United States

No. 13-485

COMPTROLLER OF THE TREASURY OF MARYLAND, PETITIONER

v.

BRIAN WYNNE, ET UX.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF MARYLAND

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

At the invitation of the Court, the United States filed a brief as amicus curiae at the petition stage of this case.

STATEMENT

1. The State of Maryland funds its operations in part through taxes on the income of its residents. Pet. App. 4-5. Each resident is subject to a general state income tax at a rate specified by the legislature. Md. Code Ann. Tax-Gen. §§ 10-102, 10-105(a) (LexisNexis 2010) (Md. Tax Code). Each resident is also subject to a county income tax at a rate not to exceed 3.2%, as specified by the county where he is domiciled or has a principal place of residence at the end of the taxable year. *Id.* §§ 10-103(a)(1), 10-106. Both taxes are collected by petitioner, Maryland's Comptroller of the

Treasury, who then distributes the proceeds of the county income tax to the appropriate counties. Pet. App. 5.

If a Maryland resident earns income in another State, the income may also be subject to taxation in that State. In addition to imposing income (and other) taxes on its own residents, a State may tax the income that nonresidents earn within its borders. See, *e.g.*, *Oklahoma Tax Comm'n* v. *Chickasaw Nation*, 515 U.S. 450, 463 n.11 (1995) (citing *Shaffer* v. *Carter*, 252 U.S. 37, 57 (1920)). Maryland imposes its state income tax (along with a special nonresident tax in place of the county tax) on income earned in Maryland by nonresidents. Md. Tax Code §§ 10-102, 10-106.1; see Pet. App. 4-5; Pet. Br. 3-4 & n.2.

Just as Maryland taxes the income of nonresidents that is earned within the State, Maryland residents' out-of-state income may be taxed by the States in which it is earned. Maryland generally grants its residents a credit, in an amount equal to the income taxes paid to other States, against the Maryland state income tax they would otherwise owe on income earned in those States. Md. Tax Code § 10-703(a). For example, if a Maryland resident has a state-income-tax rate of 5% and earns all of his income in another State with an income-tax rate of 4%, his effective Maryland state-income-tax rate is 1%.

Maryland does not offer a similar tax credit for its county income tax. Md. Tax Code § 10-703(a); see Pet. App. 7. As a result, a Maryland resident who has paid out-of-state income taxes that exceed his Maryland state-income-tax obligation cannot apply the excess to offset the county income tax. If a Maryland resident has a state-income-tax rate of 5% and a county-

income-tax rate of 2%, and earns all of his income in another State with an income-tax rate of 6%, he does not owe any state income tax to Maryland, but he still owes the 2% county income tax.

2. Respondents are a married couple. Pet. App. 8-9. In 2006, they resided in Howard County, Maryland, which had a county-income-tax rate of 3.2%. *Ibid.*; Br. in Opp. 5. Respondents owned stock in a corporation, Maxim Healthcare Services, Inc. (Maxim), that had elected to be treated as an "S corporation" under the Internal Revenue Code. Pet. App. 9. An S corporation does not pay federal income tax, but instead passes through its income to its shareholders, who then pay personal income tax on that income. See 26 U.S.C. 1366. S corporations are treated similarly under Maryland's tax code. Pet. App. 8.

In 2006, respondents earned taxable net income of $2,667,133, much of which was passed through from Maxim. Pet. App. 56. Because Maxim had earned a substantial portion of its income in States other than Maryland, it filed income-tax returns on behalf of its shareholders in 39 States. *Id.* at 9, 56. Maxim allocated to each shareholder a pro rata portion not only of its income, but also of the state taxes that it had paid. *Ibid.*

On their 2006 Maryland income-tax return, respondents claimed a tax credit of $84,550 for income taxes paid in other States. Pet. App. 56. Petitioner disallowed the claimed tax credit in part. *Ibid.* Petitioner "allowed taxes paid to other states to offset only those taxes owed to Maryland representing 'state income tax,' and not 'county income tax.'" *Ibid.*

3. Respondents appealed the resulting tax deficiency. Pet. App. 10. The Hearings and Appeals Sec-

tion of the Comptroller's Office modified the assessment slightly but otherwise affirmed. *Ibid.*

Respondents then appealed to the Maryland Tax Court, which also affirmed. Pet. App. 10, 130-141. In the tax court, respondents argued that the "limitation of the credit" to apply only to the state income tax and not to the county income tax "discriminated against interstate commerce in violation of the Commerce Clause of the United States Constitution." *Id.* at 10. This Court has interpreted the Commerce Clause—which empowers Congress to "regulate Commerce * * * among the several States," U.S. Const. Art. I, § 8, Cl. 3—to "have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." *Oregon Waste Sys., Inc.* v. *Department of Envtl. Quality*, 511 U.S. 93, 98 (1994). The tax court rejected respondents' Commerce Clause argument. Pet. App. 135-136.

The Circuit Court for Howard County reversed. Pet. App. 53-129. The circuit court agreed with respondents' Commerce Clause argument and concluded that, in the absence of a credit against the county income tax for "income earned and taxed out-of-state," Maryland's scheme "substantially burdens its residents conducting business in interstate commerce, as compared to those conducting purely intrastate commerce." *Id.* at 54. The court reasoned, *inter alia*, that if a Maryland resident earns income in a State with an income-tax rate higher than Maryland's state-income-tax rate, the resident's total tax liability (to all States) will be greater than if he had earned all of his income in Maryland (because he will pay the higher

out-of-state income tax plus the entire Maryland county income tax). *Id.* at 63-116.

4. The Court of Appeals of Maryland granted review and affirmed the circuit court's decision. Pet. App. 1-49. The court recognized that, under decisions of this Court addressing Due Process Clause challenges to various state taxes, a State "may tax the income of its residents, regardless of where that income is earned." *Id.* at 3-4 (citing *Chickasaw Nation*, 515 U.S. at 462-463 & n.11; *New York* v. *Graves*, 300 U.S. 308, 312-313 (1937)). The court held, however, that Maryland's imposition of a county income tax without a credit for out-of-state income taxes violates the Commerce Clause. *Id.* at 32.

The court of appeals explained that a Maryland resident will sometimes face greater total multistate tax liability if he earns out-of-state income than if he had earned the same total amount of income within the State. Pet. App. 16. The court concluded that "[t]his creates a disincentive for the taxpayer—or the S corporation of which the taxpayer is an owner—to conduct income-generating activities in other states with income taxes." *Ibid.* The court also believed that the Maryland tax scheme did not satisfy the four-part test set forth in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977), which requires, *inter alia*, that a state tax subject to the test be "fairly apportioned" and "not discriminate against interstate commerce." *Id.* at 279; see Pet. App. 17-32.

Two judges dissented. Pet. App. 36-49. The dissenting judges observed that respondents "live in Howard County where they benefit from the services provided by that county," and that it "'is not a purpose of the Commerce Clause to protect state residents

from their own state taxes.'" *Id.* at 37 (quoting *Goldberg* v. *Sweet*, 488 U.S. 252, 266 (1989)). The dissenting judges also recognized that States can, in some circumstances, permissibly "impose taxes that may result in some overlap in taxation of income." *Id.* at 40 (citing *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 278-279 (1978)). They emphasized that Maryland's tax system "does not expressly discriminate against interstate commerce" because the county income tax "is directed at income earned by residents of Howard County, not interstate commerce." *Id.* at 41. They also concluded that respondents had failed to prove that Maryland's system "places more than an incidental burden upon interstate commerce." *Ibid.*; see *id.* at 44-48.

5. The court of appeals denied reconsideration. Pet. App. 52. The court issued a short opinion suggesting, *inter alia*, that Maryland might avoid Commerce Clause concerns not only through tax credits but also through other methods. *Id.* at 50-52.

SUMMARY OF ARGUMENT

The Court of Appeals of Maryland erred in concluding that Maryland must grant a credit against its residential county income tax for income taxes paid to other States. The Constitution has always permitted States to impose taxes, including taxes proportional to income, on individuals who enjoy the privileges of residency. Although States often choose to grant credits to residents for income taxes paid in other States, the Commerce Clause does not compel a State to offer such credits or otherwise to defer to other States in the taxation of its own residents' income.

A. This Court has long recognized that States have the power to tax the entire income, wherever

earned, of their own residents. Whether a resident earns income in-state, out-of-state, or both, he benefits significantly from the rights, protections, and privileges that his State of residence provides. A State that elects to distribute the shared costs of government among its residents in proportion to their incomes may choose to reduce the contribution required of a particular resident based on that resident's payment of income taxes to other States. Such a choice, however, "is an independent policy decision and not one compelled by jurisdictional considerations." *Oklahoma Tax Comm'n* v. *Chickasaw Nation*, 515 U.S. 450, 463 n.12 (1995) (citation omitted).

A State's taxation of its own residents' income is structurally limited by the political will of those residents, not by the unilateral taxation policies of other States. Decisions of this Court explicating that principle have primarily addressed challenges to state taxes under the Due Process Clause. The Court has repeatedly recognized, however, that a State's power to tax its own residents' income is an attribute of state sovereignty. If the Commerce Clause required States to forgo residential income-tax revenue whenever a resident pays out-of-state income taxes, a longstanding and significant principle of this Court's state-taxation jurisprudence would be a virtual dead letter.

B. This Court has applied the Commerce Clause to invalidate "protectionist" laws that favor in-state over out-of-state economic interests. Maryland's county income tax, which is similar to certain founding-era taxes, is not such a law. Consistent with the Commerce Clause, States may choose to provide local services, such as public education, exclusively to state residents. A logical corollary to that rule is that

States may fund such services by collecting taxes from their residents, including taxes on income earned outside the State. And because taxes paid to other States do not defray the cost of benefits that the State of residence provides, the State of residence need not reduce its own income-tax assessments to reflect those payments.

Relying on this Court's decision in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977), the court below concluded that Maryland's county income tax is unconstitutional because it is unfairly apportioned and discriminates against interstate commerce. But to the extent that the factors described in *Complete Auto* are applicable here, they confirm, rather than refute, the constitutionality of the county income tax. First, an income tax is fairly apportioned so long as a State does not apply it to a portion of a taxpayer's income that is exclusively taxable only by another State. Maryland's county income tax satisfies that requirement because *no* portion of a Maryland resident's income is categorically beyond Maryland's reach. Second, the county income tax—which taxes in-state and out-of-state income at an identical rate—does not discriminate against interstate commerce. A Maryland resident's total (multistate) tax bill for out-of-state income will be higher than for in-state income only if *another* State has chosen to tax the income at a rate higher than Maryland's own state income tax. Higher total taxes for a resident who earns income out-of-state are commonplace, even in States with *no* income tax, and any increased tax burden resulting from the combination of two different States' laws is not discrimination attributable to Maryland.

The tax at issue here cannot properly be deemed invalid by analogy to certain types of taxes on property or on corporate income. The relationship between a State and its individual residents is different in kind from its relationship to a multistate corporation, even if the corporation is "domiciled" in that State. And respondents identify no sound reason to believe that rejection of their novel Commerce Clause theory will have any significant detrimental effect on interstate commercial activity.

ARGUMENT

MARYLAND'S COUNTY INCOME TAX IS CONSTITUTIONAL

A. The Taxation Policies Of Other States Do Not Limit A State's Sovereign Authority To Tax Its Own Residents' Income

1. It is a "well-established principle of interstate and international taxation" that "a jurisdiction * * * may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Oklahoma Tax Comm'n* v. *Chickasaw Nation*, 515 U.S. 450, 462-463 (1995). "Domicil itself affords a basis for such taxation" because "[e]njoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government." *Id.* at 463 (quoting *New York* v. *Graves*, 300 U.S. 308, 313 (1937)). "These are rights and privileges which attach to domicil within the state," and "[n]either the privilege nor the burden is affected by the character of the source from which the income is derived." *Ibid.* (quoting *Graves*, 300 U.S. at 313).

As the Court observed nearly two centuries ago, the "people of a State * * * give to their govern-

ment a right of taxing themselves and their property, and as the exigencies of government cannot be limited, they prescribe no limits to the exercise of this right, resting confidently on the interest of the legislator, and on the influence of the constituents over their representative, to guard them against its abuse." *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316, 428 (1819).[1] In accordance with that principle, this Court has frequently rejected claims that taxes on a resident's out-of-state income violate the Due Process Clause for lack of a sufficient "connection" or "relat[ionship]," *Quill Corp.* v. *North Dakota*, 504 U.S. 298, 306, 313 (1992) (citations omitted), to the taxing State. The Court has held, for example, that a State "may tax its residents upon net income from a business whose physical assets, located wholly without the state, are beyond its taxing power," *Graves*, 300 U.S. at 313 (citing, *inter alia*, *Lawrence* v. *State Tax Comm'n*, 286 U.S. 276 (1932)); "may tax net income from bonds held in trust and administered in another state," *ibid.* (citing *Maguire* v. *Trefry*, 253 U.S. 12, 14 (1920)); and may tax the income from rental properties located in other States, *id.* at 312-316.

2. A State does not lose authority to tax its own residents' income simply because the State in which the income was earned also taxes that income. "Although sovereigns * * * sometimes elect not to" exercise their "authority to tax all income of their

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[1] *McCulloch*'s reference to "property" is best understood as a reference to property located in the State. A State cannot necessarily tax property located out-of-state simply because its owner is a state resident. See, *e.g.*, *Safe Deposit & Trust Co.* v. *Virginia*, 280 U.S. 83, 93 (1929) ("Tangible personal property permanently located beyond the owner's domicile may not be taxed at the latter place.").

residents," and thus "commonly credit income taxes paid to other sovereigns," that "is an independent policy decision and not one compelled by jurisdictional considerations." *Chickasaw Nation*, 515 U.S. at 463 n.12 (internal quotation marks and citation omitted). A constitutional rule requiring an automatic tax credit whenever a resident's income is subject to tax in another State would impose anomalous constraints on state sovereignty. Suppose that many residents of State A, which has an income-tax rate of 4%, work (and earn all of their income) in State B. If State B has no income tax, then State A can collect the full 4% from those residents. But if the legislature of State B imposes a 2% income tax, then State A's tax collections from those residents will be halved. And if State B imposes a 4% income tax, then State A cannot collect *any* income tax from those residents unless it increases its income-tax rate.

It would make little sense for a State's power to collect an income tax from its own residents, in order to fund the services and protection those residents receive, to be circumscribed by the independent actions of another State with a less significant connection to those persons. Cf. *McCulloch*, 17 U.S. (4 Wheat) at 431 ("Would the people of any one State trust those of another with a power to control the most insignificant operations of their State government? We know they would not."). An individual may receive such important benefits as schools, emergency services, health and welfare benefits, utilities, and various legal protections from his State of residence, and it is the only State whose officials are politically accountable to him. If State A's authority to tax its residents' income were contingent on State B's

taxing decisions, then State B's officials could limit the range of options available to State A in matters of fiscal policy. In particular, any increase in State B's income-tax rate would force State A's legislators either to forgo revenue (and likely cut programs that benefit its residents) or to generate revenue in other ways (likely by increasing taxes that affect its residents). Nothing in the Constitution, and no decision of this Court, compels that result. See, *e.g.*, *Mobil Oil Corp.* v. *Commissioner*, 445 U.S. 425, 444 (1980) ("[T]he constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy.").

3. As respondents have emphasized (Br. in Opp. 13-17), this Court's decisions recognizing States' broad authority to tax their own residents have typically addressed challenges to state taxes brought under the Due Process Clause. In articulating the applicable constitutional rule, however, the Court has not simply stated that particular constitutional provisions, such as the Due Process Clause, do not limit a State's power to tax its residents' income. Rather, it has described the power to tax all such income as an affirmative aspect of state sovereignty. See, *e.g.*, *Lawrence*, 286 U.S. at 281 ("We can find no basis for holding that taxation of the income at the domicile of the recipient * * * is in any respect so arbitrary or unreasonable as to place it outside the constitutional power of taxation reserved to the state."); *Shaffer* v. *Carter*, 252 U.S. 37, 57 (1920) ("As to residents [a State] may, and does, exert its taxing power over their income from all sources, whether within or without the State."). In *Oklahoma Tax Comm'n* v. *Chickasaw Nation*, *supra*, the Court summarized its prior decisions by asserting without qualification that a State

"may tax *all* the income of its residents," and that offering a credit for taxes paid to other sovereigns is a "policy decision" that is "not * * * compelled by jurisdictional considerations." 515 U.S. at 462-463 & n.12 (internal quotation marks and citation omitted).

The constitutional rule urged by respondents and adopted by the court below, which would compel such a credit, not only is contrary to the Court's traditional understanding of state authority in this area, but also would effectively overrule specific precedents that reflect that understanding. In *Fidelity & Columbia Trust Co.* v. *City of Louisville*, 245 U.S. 54 (1917), for example, this Court held that a city in Kentucky could tax bank deposits belonging to one of its residents, notwithstanding that the deposits represented the proceeds of a Missouri business and were held in a Missouri bank. *Id.* at 57-60. Although the Court accepted that "the Missouri deposits could have been taxed in that State," it recognized Kentucky's overlapping authority to impose "a tax upon the person * * * for the general advantages of living within the jurisdiction * * * measured more or less by reference to the riches of the person taxed." *Id.* at 58. On respondents' theory, however, Kentucky's taxing authority would have been contingent on the existence and size of any Missouri tax.

The rule urged by respondents and adopted below would also effectively nullify *Lawrence* v. *State Tax Commission*, *supra*, in which the Court concluded that the Due Process Clause permitted Mississippi to tax the net income that a Mississippi resident had earned on the construction of public highways in Tennessee. 286 U.S. at 279-281. This Court has understood *Lawrence*, and other decisions, to hold that "income may

be taxed both by the state where it is earned and by the state of the recipient's domicile." *Curry* v. *McCanless*, 307 U.S. 357, 368 (1939); see *id.* at 363 n.1, 368 n.4 (also citing, *inter alia*, *Graves*, 300 U.S. at 308, and *Guaranty Trust Co.* v. *Virginia*, 305 U.S. 19 (1938)); see also Reply Br. at 32, *Lawrence*, *supra* (No. 31-580) (representing that both Mississippi and Tennessee were effectively imposing "an income tax upon the same occupation"). Respondents have hypothesized (Supp. Br. 9) that, in at least some of the cases in which that principle has been applied, the tax laws of the State of residence might have "allowed a credit" for taxes paid out-of-state. But whether or not that is so, the Court's decisions did not rely on the existence of such a credit. To the contrary, the Court has made clear that a State's sovereign power to tax all the income of its residents, wherever earned, does not depend on its willingness to provide such a credit. See *Chickasaw Nation*, 515 U.S. at 462-463 & n.12; see also, *e.g.*, *Guaranty Trust Co.*, 305 U.S. at 22 (describing the authority of two States to tax the "same income").

B. With Respect To Taxation Of An Individual's Income, The Commerce Clause Does Not Give The State Where The Income Is Earned Priority Over The Taxpayer's State Of Residence

The Commerce Clause "does not expressly impose any constraints on 'the several States,' and several Members of the Court have expressed the view that it does not do so." *McBurney* v. *Young*, 133 S. Ct. 1709, 1719 (2013). The Court has "[n]onetheless * * * long inferred that the Commerce Clause itself imposes certain implicit limitations on state power." *Ibid.* The States that ratified the Commerce Clause, however,

would not have understood it to subordinate their "ordinary prerogative to tax the income of every resident," *Chickasaw Nation*, 515 U.S. at 464, to a right of first refusal by the State in which the income is earned.

States may constitutionally choose to provide important government services only to their own residents. States may accordingly insist that residents pay their fair share of the costs of those services, and they may determine each resident's fair share by reference to that resident's total income, regardless of where that income is earned. And because States are politically accountable to their own residents, the constitutional limitation that respondents advocate is unnecessary to prevent state overreaching in the sphere of individual income taxation.

1. ***Allocating the costs of local government services to residents in proportion to their total pre-tax income does not offend the Commerce Clause***

Both before and after the ratification of the Commerce Clause, some States imposed taxes keyed to income that did not appear to provide explicit credits for similar taxes paid elsewhere.[2] A tax of that sort is

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[2] See, *e.g.*, 1777-78 Mass. Acts ch. 13, § 2, at 756 (imposing a tax upon "the amount of [residents'] income from any profession, faculty, handicraft, trade or employment; and also on the amount of all incomes and profits gained by trading by sea and on shore"); 1781 Pa. Laws ch. 961, § 12, at 390 ("[A]ll offices and posts of profit, trades, occupations and professions (that of ministers of the gospel of all denominations and schoolmasters only excepted), shall be rated at the discretion of the township, ward or district assessors * * * having due regard to the profits arising from them."); Delos O. Kinsman, *The Income Tax in the Commonwealths of the United States* 12-13, 17 (1903) (explaining that the Massachusetts

consistent with both original and current understandings of the Commerce Clause.

In an effort to "effectuate the Framers' purpose," the "modern law of what has come to be called the dormant Commerce Clause is driven by concern about economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Department of Revenue* v. *Davis*, 553 U.S. 328, 337-338 (2008) (internal quotation marks, brackets, and citations omitted). Accordingly, the "crucial inquiry" in evaluating a Commerce Clause challenge to a state law "must be directed to determining whether [the law] is basically a protectionist measure, or whether it can fairly be viewed as a law directed to legitimate local concerns, with effects upon interstate commerce that are only incidental." *City of Phila.* v. *New Jersey*, 437 U.S. 617, 624 (1978); see *McBurney*, 133 S. Ct. at 1719-1720.

A tax like Maryland's—which allocates the cost of local government services to individual state residents in proportion to each resident's total income, irrespective of whether the resident also pays out-of-state income tax—falls into the latter category. Since the founding era, income taxes have been "a recognized method of distributing the burdens of government, favored because [they] requir[e] contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax

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and Pennsylvania taxes continued, in some form, through the beginning of the nineteenth century); see also *Shaffer*, 252 U.S. at 51 (noting that "[t]axes of [the] character" of income taxes "were imposed by several of the States at or shortly after the adoption of the Federal Constitution").

may be readily proportioned to their ability to pay." *Shaffer*, 252 U.S. at 51. The purpose of Maryland's scheme is not to interfere with residents' ability to do business in other States, but instead to ensure that each resident, "regardless of * * * another state's method or rate of taxation," pays his fair share for the local services that all residents receive. Pet. App. 6.

The nonprotectionist character of a State's efforts to collect such a generalized-services fee, even from residents who pay income taxes out-of-state, follows logically from this Court's precedents. The Court has viewed as constitutional a variety of "rules restricting to state residents the enjoyment of state educational institutions, energy generated by a state-run plant, police and fire protection, and agricultural improvement and business development programs." *Reeves, Inc.* v. *Stake*, 447 U.S. 429, 442 (1980). "Such policies, while perhaps 'protectionist' in a loose sense, reflect the essential and patently unobjectionable purpose of state government—to serve the citizens of the State." *Ibid.* A State thus does not offend the Commerce Clause by "limit[ing] benefits generated by [such] a state program to those who fund the state treasury and whom the State was created to serve." *Ibid.*; see *McBurney*, 133 S. Ct. at 1720 (same). The principle that States may favor residents in the provision of certain local services—on the ground that residents "fund the state treasury"—cannot be squared with a constitutional rule that would entitle a resident to pay less for those services simply because he also makes payments to the treasuries of *other* States.

Respondents acknowledge that States may collect from their residents a generalized-services fee that is indexed to the value of their residential property,

without any requirement to reduce a resident's payment obligation based on taxes paid to other States. See Br. in Opp. 23 (stating that "property taxes * * * are not subject to credit"). Such a fee does not lose its nonprotectionist character simply because the State elects to index the fee to a resident's income, rather than to the value of his residence. See, *e.g.*, *Graves*, 300 U.S. at 313 ("A tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits."). Although property taxes may be a more common source of local revenue than income taxes, see Supp. Br. 12, the Commerce Clause does not preclude a State from funding local government through an income tax with a fixed minimum rate for residents. See, *e.g.*, *Miller Bros.* v. *Maryland*, 347 U.S. 340, 345 (1954) ("[T]he fact of residence creates universally recognized reciprocal duties of protection by the state and of allegiance and support by the citizen. The latter obviously includes a duty to pay taxes, and their nature and measure is largely a political matter.").

State residents cannot reasonably expect to enjoy local governmental services without paying for them. See, *e.g.*, Howard County, Maryland, *Fiscal Year 2014 Approved Operating Budget Detail* 5 (Howard County budgeted more than $903 million for education in fiscal year 2014), available at http://www.howardcountymd.gov/departments.aspx?ID=499. "It is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Goldberg* v. *Sweet*, 488 U.S. 252, 266 (1989). The Court has accordingly distinguished for Commerce Clause purposes between taxes that burden nonresidents, "who would have difficulty

effecting legislative change," and taxes that are paid by residents, "who presumably [are] able to complain about and change the tax through the [state] political process." *Id.* at 266. The residents of a State may democratically decide—as States since the founding era have decided—that the fairest way to distribute all or some of their joint financial burden is through a tax proportioned to income. The decision to adopt such a scheme should not entitle residents paying out-of-state income taxes to pay less than their democratically-allocated fair share of the cost of local services.

2. ***Maryland's county income tax is not unfairly apportioned and does not discriminate against interstate commerce***

At respondents' urging, the court below analyzed Maryland's tax scheme under the four-part test set forth in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977). See Pet. App. 17-32; Resp. C.A. Br. 20-36. Under that test, this Court "will sustain a tax against Commerce Clause challenge so long as 'the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.'" *Trinova Corp.* v. *Michigan Dep't of Treasury*, 498 U.S. 358, 372 (1991) (quoting *Complete Auto*, 430 U.S. at 279). Maryland's county income tax qualifies for that constitutional safe harbor.[3] Respondents have not

[3] The *Complete Auto* test was not designed to evaluate the constitutionality of a State's taxation of its own residents' income. See, *e.g.*, Pet. App. 41 n.2 (Greene, J., dissenting) (observing that, "[i]n most of the cases where the Supreme Court has subjected a tax to the *Complete Auto* test, the tax was directly on interstate commerce itself or items in interstate commerce"). A nonprotectionist tax of

disputed that "application of the county tax in this case has a substantial nexus to Maryland or that it is fairly related to services provided by the State." Pet. App. 17-18; see, *e.g.*, *Graves*, 300 U.S. at 313 (recognizing the "direct relationship" between "the economic advantage realized by the receipt of income and represented by the power to control it" and "the equitable distribution of the tax burden"). And, contrary to the view of the state court of appeals (Pet. App. 17-32), the county income tax also "is fairly apportioned" and "does not discriminate against interstate commerce." *Complete Auto*, 430 U.S. at 279.

Fair apportionment. The "central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg*, 488 U.S. at 260-261. Maryland's county income tax is fairly apportioned because Maryland's taxable "fair share" of its residents' income is the entirety of that income, wherever earned. See *Chickasaw Nation*, 515 U.S. at 462-463. A State's right to tax its resident's whole income "is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received." *Graves*, 300 U.S. at 313.

The state court of appeals concluded that Maryland's county income tax lacks "external consistency" because, in the absence of a credit, it "'reaches beyond that portion of value that is fairly attributable to economic activity within the taxing [S]tate.'" Pet. App. 26 (quoting *Oklahoma Tax Comm'n* v. *Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995)). That conclusion

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the sort at issue here would accordingly be constitutional even if it did not qualify for the *Complete Auto* safe harbor.

is inconsistent with a State's sovereign authority to tax all of its residents' income, and it departs significantly from this Court's income-tax-apportionment jurisprudence.

In the context of income taxation, this Court has implemented the Commerce Clause's general "prohibition against multiple taxation," *Jefferson Lines*, 514 U.S. at 182, by focusing on "specific formulas for slicing a taxable pie among several States in which the taxpayer's activities contributed to taxable value," *id.* at 186. The Court has held, for example, that California cannot apply a tax (of 5.5%) to all of an out-of-state corporation's income, but instead may tax only the fraction of the corporation's income that represents a rough approximation of the "value * * * generated" in California. *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159, 164, 175 n.12, 183 (1983). The size of that "slic[e]" of the "taxable pie" does not depend on whether other States actually impose taxes on the remainder of the taxpayer's income. *Jefferson Lines*, 514 U.S. at 186.

The apportionment argument advanced by respondents, and adopted by the court below, does not fit that framework. Respondents have not contended that, whenever a Maryland resident earns income in other States, Maryland may tax only a fixed portion of that income. Such a rule would mean that some percentage of a Maryland resident's out-of-state income is beyond Maryland's power to tax *even if* the State in which the income is earned does not impose any tax upon it. Respondents instead appear to accept that every dollar earned by a Maryland resident, including dollars earned through out-of-state activity, may be taxed in full by Maryland *unless* the State in which

the income is earned imposes its own tax upon that income. In respondents' view, the county tax is constitutionally infirm only because it does not include a credit for out-of-state taxes actually imposed and paid on Maryland residents' out-of-state income. See, *e.g.*, Supp. Br. 11; see also, *e.g.*, Pet. App. 30, 34. That view, under which Maryland's taxing authority would be contingent on taxing decisions of other States, cannot be reconciled with this Court's Commerce Clause precedents. See, *e.g.*, *Armco Inc.* v. *Hardesty*, 467 U.S. 638, 644-645 (1984) (rejecting approach under which "the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax codes of 49 other States").[4]

The court below was also mistaken in concluding (Pet. App. 19-25) that Maryland's county income tax is invalid because it fails this Court's "internal consistency" test. That test examines "the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate

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[4] In circumstances in which a State might *otherwise* be taxing more than its fair share of an interstate transaction, the presence of a tax credit may (at least in some non-income-tax contexts) alleviate apportionment concerns, because it cedes primary taxing authority to the jurisdiction with the stronger claim. See, *e.g.*, *Goldberg*, 488 U.S. at 264 (tax on phone calls); *D.H. Holmes Co.* v. *McNamara*, 486 U.S. 24, 31 (1988) (tax on catalogs). But in the context of a residential income tax like Maryland's, it makes little sense to view the question whether Maryland is taxing an unduly large "portion of value," *Jefferson Lines*, 514 U.S. at 185, as turning on the presence or absence of a tax credit. Even with a tax credit, the county income tax would still be computed by reference to a resident's entire income. Although a tax credit would allow the resident to subtract his out-of-state income-tax bills from the amount that Maryland would otherwise *collect*, the credit would not reduce the *portion* of income subject to the county tax.

commerce at a disadvantage as compared with commerce intrastate." *Jefferson Lines*, 514 U.S. at 185. The Court has found the test a useful proxy for the "threat of malapportionment" because "allowing [a tax that fails the test] in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax." *Ibid.* But the Court has not invariably required that a tax satisfy the test in order to survive a Commerce Clause challenge, see *American Trucking Ass'ns, Inc.* v. *Michigan Pub. Serv. Comm'n*, 545 U.S. 429, 438 (2005), and the test is ill-suited to evaluating a State's tax on its own residents' income.

In describing the purpose of the "internal consistency" test, the Court has explained that "[a] failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction." *Jefferson Lines*, 514 U.S. at 185. The county tax at issue here, however, is not imposed on "interstate transaction[s]" as such, but on Maryland residents *qua* residents. See *Graves*, 300 U.S. at 313 ("Domicil itself affords a basis for such taxation."). Nothing in this Court's decisions suggests that the "internal consistency" test was intended to supersede the established understanding that a State may tax its residents' entire income wherever earned. Respondents, moreover, do not offer any plausible alternative constitutional formula for determining Maryland's "fair share of taxes" on income earned by its residents outside the State. Rather, their argument is that, if the State in which the income is earned taxes that income at a rate equal to or greater than the applicable Maryland tax

rate, Maryland is constitutionally precluded from collecting any tax at all on that income.

If every State taxed all the income of its own residents, and only of its own residents, there would be no plausible argument that interstate commerce was disadvantaged. Adoption by every State of a county income tax equivalent to Maryland's therefore would not, in and of itself, violate the "internal consistency" test. That would remain true even if every State also imposed a separate tax on the earning of income in-state, applicable to residents and nonresidents alike, as Maryland does. In that scenario, everyone would pay the county income tax once (to his State of residence) and the tax on earning income once (to the State in which it was earned, whether or not the State of residence), irrespective of where his income-earning activities occur.

The court below found Maryland's overall tax scheme internally inconsistent only because Maryland, in addition to the taxes just described, imposes an additional special nonresident tax (as an alternative to the county income tax) on income earned in Maryland by *non*residents. Md. Tax Code § 10-106.1; see Pet. App. 5, 20-22 (internal-consistency analysis finding that out-of-state income results in additional tax burden equal to special nonresident tax in State where income was earned). Respondents are not subject to that tax, have not challenged it, and suffer no injury from it. There is no logical reason that Maryland's "fair share of taxes," *Jefferson Lines*, 514 U.S. at 185, on its own residents' income should depend on whether, and to what extent, Maryland also taxes income earned by nonresidents within the State.

Discrimination against interstate commerce. Maryland's county income tax does not "discriminate[] against interstate commerce either on its face or in practical effect," but instead "regulates evenhandedly with only 'incidental' effects on interstate commerce." *Hughes* v. *Oklahoma*, 441 U.S. 322, 336 (1979). Respondents do not contend that it is discriminatory for a State to impose a special tax only on residents. See, *e.g.*, *United Haulers Ass'n, Inc.* v. *Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338 (2007) (explaining that "discrimination" under the Commerce Clause includes only discrimination that disfavors "out-of-state economic interests") (citation omitted). And Maryland's county income tax applies to all residents of the State. Although the precise rate varies depending on the taxpayer's county of residence, the rate for any particular county is the same regardless of whether income is earned in-state or out-of-state. See, *e.g.*, *id.* at 345 (no discrimination where statute did not distinguish between in-state and out-of-state interests); *Northwest Cent. Pipeline Corp.* v. *State Corp. Comm'n*, 489 U.S. 493, 523 (1989) (similar); *Minnesota* v. *Clover Leaf Creamery Co.*, 449 U.S. 456, 471-472 (1981) (similar).[5]

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[5] Unlike certain taxes that this Court has previously found to be discriminatory, the amount of the county income tax is in no way tied to the amount of interstate commerce in which the taxpayer engages. See, *e.g.*, *Fulton Corp.* v. *Faulkner*, 516 U.S. 325, 333 (1996) (invalidating "facially discriminat[ory]" scheme that "taxe[d] stock only to the degree that its issuing corporation participates in interstate commerce"); *Camps Newfound/Owatonna, Inc.* v. *Town of Harrison*, 520 U.S. 564, 572 (1997) (invalidating "discriminatory tax exemption" whose application depended "on the residence of the consumers that [the taxpayer] serve[d]").

The state court of appeals believed that Maryland's income-tax system discriminates against interstate commerce because Maryland residents may sometimes pay higher total (in-state plus out-of-state) taxes on out-of-state income than on in-state income. See Pet. App. 30. But if it were considered discriminatory to adopt a tax scheme under which residents would sometimes pay lower taxes on income earned in-state, then any number of state taxation systems would be constitutionally infirm. Residents of a State with no income tax, but with a residential-property tax or a flat-fee residence tax, will have higher total tax bills if they earn income in another State that has an income tax than if they earn the same income locally. The Commerce Clause, however, does not require *every* resident-specific state tax to give way to the nonresident income taxes imposed by other States. See, *e.g.*, *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 623-624 (1981) ("[I]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.") (citation omitted).

Contrary to the court of appeals' suggestion (Pet. App. 30), a residential income tax does not in itself incentivize the earning of income in-state. Notwithstanding the existence of such a tax, a resident would be indifferent between earning income in-state and earning income in another State that has no income tax of its own. And under Maryland's particular income-tax scheme, a resident would have no inherent reason to prefer earning income in Maryland over earning income in a State with an income-tax rate less than Maryland's own state-income-tax rate. See p. 2,

supra (numerical example). The absence of any unique advantage to earning income in the State of residence underscores that a residential income tax does not unconstitutionally favor in-state interests. See *Amerada Hess Corp.* v. *Director*, 490 U.S. 66, 78 n.10 (1989) (finding a state tax constitutional where, *inter alia*, it did not inherently incentivize taxpayer to move its activities to the taxing State).

Respondents contend that "Maryland's scheme is discriminatory" because respondents "are double-taxed on a portion of their income and similarly situated Marylanders who earn income entirely in-state are not." Supp. Br. 11 (emphasis omitted). The precise import of that statement is unclear. Respondents do not argue that a constitutional violation occurs whenever a Maryland resident's out-of-state income is taxed at a rate higher than the rate that would apply to income earned in Maryland. To the contrary, respondents recognize that, regardless of whether Maryland offers tax credits, Maryland residents *always* "will pay higher taxes" on income earned in any State that "applies a higher tax rate than Maryland does," and "there is nothing wrong with that." *Ibid.* Respondents also do not appear to contend that the Commerce Clause is violated whenever two States tax the same income, since that could often occur even if the State of residence offered a credit for out-of-state taxes. Respondents' theory appears to be that these two factors taken together produce a constitutional violation, even though neither in isolation would do so; but that theory is untethered to any reasonable understanding of the Commerce Clause.

Although respondents may pay more in total income taxes than do Maryland residents who earn

equivalent incomes wholly within the State, respondents are wrong to attribute that disparity to differential treatment *by Maryland*. Indeed, because Maryland credited out-of-state taxes in computing respondents' liability for state (though not county) income taxes, see Pet. App. 56, Maryland ultimately took a *smaller* share of the income that respondents earned outside the State than of the income they earned in Maryland. Rather, the disparity of which respondents complain results from the fact that, whereas income earned in Maryland by a Maryland resident could not be taxed by any other State, respondents chose to engage in conduct that subjected them to other States' taxing powers as well. In *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978), this Court found no "discriminat[ion] against interstate commerce" where alleged taxation disparities were "the consequence of the combined effect" of two state income-tax schemes, each of which was otherwise constitutional. *Id.* at 277 n.12. The Court reasoned that "the 'discrimination' d[id] not inhere in either State's" statute, and that the State whose law had been challenged was "not responsible" for the other State's scheme. *Ibid.*

Respondents suggest that this case is different because "Maryland made a deliberate choice to deny its citizens a credit on out-of-state income." Supp Br. 11 (emphasis omitted). It is equally true, however, that the other States in which respondents' income was taxed deliberately chose not to offer respondents a credit for their Maryland county income taxes. If the combined effect of the two States' taxing schemes were found to give rise to a Commerce Clause violation, the Court would need to decide which State is required to give way—or, to put the matter different-

ly, would need to decide whether the residence of the taxpayer or the location where income is earned is a constitutionally preferred basis for state taxation of particular income. Nothing in this Court's decisions compels such a choice, let alone dictates that a taxpayer's State of residence (on which the taxpayer primarily depends for basic governmental services, and in which the taxpayer possesses rights of political participation) must defer to another State's tax policies.

3. ***Respondents' additional objections to Maryland's tax scheme lack merit***

Contrary to respondents' contention (*e.g.*, Supp. Br. 7-8), this Court's decisions addressing (and sometimes invalidating) state property-tax schemes are not controlling here. See *ibid.* (citing *Japan Line, Ltd.* v. *County of L.A.*, 441 U.S. 434 (1979) (invalidating state tax on value of cargo containers owned by foreign company and already fully taxed by Japan); *Standard Oil Co.* v. *Peck*, 342 U.S. 382, 384-385 (1952) (invalidating state tax on full value of out-of-state property of domestic corporation)). Income taxation operates on principles different from those that govern property taxation. See, *e.g.*, *Container Corp.*, 463 U.S. at 188; see also *id.* at 188-189 & n.24 (noting that the result in *Japan Line* relied heavily on the fact that foreign, rather than purely interstate, commerce was involved). Decisions involving sales taxes, gross-receipt taxes (which are akin to sales taxes, see, *e.g.*, *Jefferson Lines*, 514 U.S. at 179 n.3), and other non-income taxes likewise have no direct bearing on the question presented in this case.

Respondents are also wrong to focus (Supp. Br. 8-9) on whether the Commerce Clause requires States

to offer credits for out-of-state income taxes paid by corporations. Because this case involves a personal income tax on individual state residents, the Court need not and should not address the constitutionality of any hypothetical corporate income tax.[6] The constitutional limitations on state taxation of an in-state corporation's income need not be precisely identical to the constitutional limitations on state taxation of individual residents' personal income. For reasons explained above (see pp. 16-19, *supra*), the relationship between an individual resident and the State in which he resides is unique and different in kind, in terms of both its benefits and its burdens, from the relationship between that resident and a State in which he merely earns income. Even a resident who earns all his income elsewhere will reap the benefits of local roads, local police and fire protection, local public schools, local health and welfare benefits, and the right to vote in the State where he resides.

The same is not true for corporations, which have a fundamentally economic relationship with each State in which they are present, including the State in which they are domiciled. Domestic corporations do not, for example, have children who attend public school or a right to vote to repeal taxes they disfavor. The benefits conferred on a corporation by its State of domicile —laws and services that aid in revenue generation— are not qualitatively different from the benefits conferred by other States in which the corporation does

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[6] Respondents assert (Supp. Br. 8) that this case does involve "corporate income" because it concerns pass-through income from an S corporation. But the purpose and effect of S-corporation designation is that the income is treated as personal income under both Maryland and federal law. See p. 3, *supra*.

business.[7] That qualitative similarity is reflected in the fact that States that tax net corporate income do not meaningfully distinguish between domestic and foreign multistate corporations for income-tax purposes, but instead in each case use apportionment formulas to determine the fraction of corporate income subject to taxation. 1 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 8.02[3], at 8-27 (3d ed. 2014) (Hellerstein).

It is an open question whether States are constitutionally *required* to apportion the income of a domestic corporation in that fashion. Hellerstein, ¶ 8.02[3], at 8-27 (observing that this Court has not addressed that issue); see, *e.g.*, *Mobil Oil*, 445 U.S. at 445-446 (reserving question of how New York might tax certain dividend income of a domestic corporation). But the *feasibility* of comparing a domiciliary State's interest to a nondomiciliary State's interest, and apportioning the income between such States, significantly differentiates corporate income taxation from personal income taxation. Cf. *Miller Bros.*, 347 U.S. at 345 & nn. 8, 17 (categorizing seperately decisions of this Court allowing taxation of individuals' income on the basis of "residence" from decisions "in which incorporation by a state * * * forms the basis for proportionate taxation of a company, including its * * *

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[7] Respondents contend (Supp. Br. 8) that "a corporation *does* have a special relationship with its state of domicile" because "a corporation is 'at home' in its domiciliary state and is subject to the state's pervasive general jurisdiction." But whatever relevance the "at home" relationship may have to the Commerce Clause, the relationship is not unique, as a corporation may be "at home" in multiple States, including both its "place of incorporation" and its "principal place of business." *Daimler AG* v. *Bauman*, 134 S. Ct. 746, 760 (2014). That is not true of individuals.

income"). The possibility that the Commerce Clause analyses might be different in the two contexts simply reflects the fact that individuals and corporations interact with States in different ways.

Finally, respondents suggest (Supp. Br. 12-13) that upholding Maryland's tax scheme will have a "tremendous" adverse practical impact. That suggestion lacks foundation. In Maryland, where residents have been subject for nearly 40 years to a county income tax without an out-of-state-tax credit, reversing the lower court would simply preserve the status quo. See Pet. App. 7; see also Pet. C.A. Reconsideration Mot. 9 (explaining that reciprocity agreements with most neighboring jurisdictions limit the amount of out-of-state income taxes that Maryland residents actually pay). The same is true of other jurisdictions that may have similar taxes. See Supp. Br. 5.

Decisions of this Court (and of other courts) have long recognized the broad authority of States to tax their own residents' income. See U.S. Cert. Br. 18-20. A ruling in petitioner's favor would simply confirm the established understanding that, although States often offer their residents credits for income taxes paid to other States, they have no constitutional obligation to do so. There is thus no sound reason to suppose that reversing the decision below would precipitate a repeal of such credits by States that currently provide them. Accordingly, and particularly because Congress would have the authority to address any problems that might arise, see, *e.g.*, *Moorman Mfg.*, 437 U.S. at 278-280, practical considerations do not favor adoption of respondents' novel Commerce Clause theory.

CONCLUSION

The judgment of the Court of Appeals of Maryland should be reversed.

Respectfully submitted.

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APPENDIX

1. U.S. Const., Art I, § 8, Cl. 3 provides in pertinent part:

The Congress shall have Power * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

2. U.S. Const. Amend. XIV, § 1 provides in pertinent part:

[N]or shall any State deprive any person of life, liberty, or property, without due process of law;

3. Md. Code Ann. Tax-Gen. § 10-102 (LexisNexis 2010) provides:

Imposition of tax—In general.

Except as provided in § 10-104 of this subtitle, a tax is imposed on the Maryland taxable income of each individual and of each corporation.

4. Md. Code Ann. Tax-Gen. § 10-103(a)(1) (LexisNexis 2010) provides:

County income tax.

(a) *Required.*—Each county shall have a county income tax on the Maryland taxable income of:

(1) each resident, other than a fiduciary, who on the last day of the taxable year:

(i) is domiciled in the county; or

(ii) maintains a principal residence or a place of abode in the county;

5. Md. Code Ann. Tax-Gen. § 10-105(a) (LexisNexis 2004) provided in pertinent part:

State income tax rates.

(a) *Individual.*—The State income tax rate for an individual is:

(1) 2% of Maryland taxable income of $1 through $1,000;

(2) 3% of Maryland taxable income of $1,001 through $2,000;

(3) 4% of Maryland taxable income of $2,001 through $3,000; and

(4) for Maryland taxable income in excess of $3,000:

* * * * *

(v) 4.75% for a taxable year beginning after December 31, 2001.

6. Md. Code Ann. Tax-Gen. § 10-106 (LexisNexis 2010) provides:

County income tax rate.

(a) *In general; exception in Howard County.*—(1) Each county shall set, by ordinance or resolution, a county income tax equal to at least 1% but not more than the

percentage of an individual's Maryland taxable income as follows:

(i) 3.05% for a taxable year beginning after December 31, 1998 but before January 1, 2001;

(ii) 3.10% for a taxable year beginning after December 31, 2000 but before January 1, 2002; and

(iii) 3.20% for a taxable year beginning after December 31, 2001.

(2) A county income tax rate continues until the county changes the rate by ordinance or resolution.

(3)(i) A county may not increase its county income tax rate above 2.6% until after the county has held a public hearing on the proposed act, ordinance, or resolution to increase the rate.

(ii) The county shall publish at least once each week for 2 successive weeks in a newspaper of general circulation in the county:

1. notice of the public hearing; and

2. a fair summary of the proposed act, ordinance, or resolution to increase the county income tax rate above 2.6%.

(4) Notwithstanding paragraph (1) or (2) of this subsection, in Howard County, the county income tax rate may be changed only by ordinance and not by resolution.

(b) *Rate change.*—If a county changes its county income tax rate, the county shall:

(1) increase or decrease the rate in increments of one one-hundredth of a percentage point, effective on January 1 of the year that the county designates; and

(2) give the Comptroller notice of the rate change and the effective date of the rate change on or before July 1 prior to its effective date.

7. Md. Code Ann. Tax-Gen. § 10-106.1 (LexisNexis 2010) provides:

Individuals subject to State tax but not county tax.

(a) *Tax imposed.*—An individual subject to the State income tax under § 10-105(a) of this subtitle, but not subject to the county income tax under § 10-106 of this subtitle, shall be subject to the tax imposed under this section.

(b) *Rate.*—The rate of the tax imposed under this section shall be equal to the lowest county income tax rate set by any Maryland county in accordance with § 10-106 of this subtitle.

(c) *Distribution.*—The tax imposed under this section shall be distributed by the Comptroller in accordance with § 2-609 of this article.

8. Md. Code Ann. Tax-Gen. § 10-703 (LexisNexis 2010) provides:

For tax paid by resident to another State.

(a) *In general.*—Except as provided in subsection (b) of this section, a resident may claim a credit only against the State income tax for a taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year.

(b) *Exceptions.*—A credit under subsection (a) of this section is not allowed to:

(1) a resident other than a fiduciary, if the laws of the other state allow the resident a credit for State income tax paid to this State;

(2) a resident fiduciary, if the fiduciary claims, and the other state allows, a credit for State income tax paid to this State;

(3) a resident for less than the full taxable year for tax on income that is paid to another state during residency in that state; or

(4) a nonresident.

(c) *Amount of credit for resident.*—(1) Except as provided in paragraph (2) of this subsection, the credit allowed a resident under subsection (a) of this section is the lesser of:

(i) the amount of allowable tax on income that the resident paid to another state; or

(ii) an amount that does not reduce the State income tax to an amount less than would be payable if the income subjected to tax in the other state were disregarded.

(2) If the credit allowed a resident under subsection (a) of this section is based on tax that an S corporation pays to another state, the credit allowable to a shareholder:

(i) may not exceed that shareholder's pro rata share of the tax; and

(ii) will be allowed for another state's income taxes or taxes based on income.

AMICUS CURIAE BRIEF

No. 13-485

IN THE

Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the Maryland Court of Appeals

BRIEF OF *AMICUS CURIAE* AMERICAN ASSOCIATION OF ATTORNEY-CERTIFIED PUBLIC ACCOUNTANTS, INC. SUPPORTING RESPONDENTS

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INTEREST OF *AMICUS CURIAE* [1]

Amicus is the American Association of Attorney-Certified Public Accountants, Inc. ("AAA-CPA"), a not-for-profit corporation, formed in 1964 and now headquartered in Virginia. The AAA-CPA has members located throughout the United States. Every "regular member" has been licensed as both an attorney and a certified public accountant.

AAA-CPA members, with both accounting and law backgrounds, have unique perspectives on business and taxes. A significant percentage of the AAA-CPA members have devoted their careers to the field of tax law, both federal taxes and state and local taxes, and represent a very wide variety of industries. As such, the AAA-CPA membership is in a unique position to view how Maryland's income tax and credit structure affects individuals who reside in Maryland but who receive source income from other states.

SUMMARY OF ARGUMENT

Maryland's failure to offer a full credit to its residents against the individual's state income tax, specifically the local component, violates the Commerce Clause of the U.S. Constitution.

While a corporation as a taxable entity is protected by an apportionment mechanism from an undue tax burden in Maryland and elsewhere, Maryland fails to accord proper protection to resident individuals with

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[1] Counsel for *amicus* represent that they authored this brief in its entirety and that none of the parties nor their counsel, nor any other person or entity other than *amicus*, its members, or its counsel have made a monetary contribution intended to fund the preparation or submission of this brief. Counsel of record for all parties have given blanket consent to the filing of *amicus* briefs.

income having a source in other states, proffering that it is taxing its residents rather than taxing their income and that any mitigation is gratuitous.

As set forth in the Argument below, the right of a state to tax the income of its residents is not beyond constraints of the Commerce Clause. Maryland must fairly apportion the income tax burden of its residents to avoid discrimination against professionals and other businesses where an owner resides in Maryland but chooses to engage in interstate commerce.

ARGUMENT

I. MARYLAND'S "PIGGYBACK" COUNTY INCOME TAX IS A STATE TAX FACILITATING REVENUE TO BE SHARED WITH ITS COUNTIES AND ITS INDEPENDENT CITY.

Intergovernmental transfers to local governments constitute approximately half a trillion dollars in annual disbursements and make up about 38 percent of local government revenues. *See* David E. Wildasin, *Intergovernmental Transfers to Local Governments* 1 (Inst. for Federalism & Intergovernmental Relations, Working Paper No. 2009-11 (2009)). In the case of most states, the amount of any income tax revenues to be transferred to localities is not separately stated as it is in Maryland.

However, given the tax structure in Maryland, the separately stated "piggyback"[2] tax is effectively

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[2] A "piggyback" is defined by Merriam-Webster as "up on the back and shoulders." MERRIAM-WEBSTER DICTIONARY 374–75 (2005). Despite a 1999 statutory modification so that the county tax was no longer a percentage of the State tax, the county tax in

indistinguishable from state aid to counties and/or revenue sharing that is more common. As published by Howard County, Maryland, residence of the Respondents, "[d]istributions of revenue [from the income tax] are made to the counties throughout the year based upon collection deadlines." HOWARD CNTY, MD. FISCAL YEAR 2015 APPROVED OPERATING BUDGET 15 (2014).[3]

Each county in Maryland is required to have a county income tax. MD. CODE ANN. TAX- GEN. § 10-103. Notwithstanding the nomenclature, it is truly a state tax. In *Frey v. Comptroller of the Treasury*, 29 A.3d 475 (Md. 2013), the Maryland Court of Appeals reiterated that, despite a statutory change at *Maryland Annotated Code, Tax General*, Section 10-703(a) purporting to prohibit a credit for taxes paid to another state against the county tax, that tax is not administered by local political subdivisions and is part of a State-administered income tax scheme and is, in fact, a state tax.[4] *Id.* at 492.

Maryland is still commonly referred to as a "piggyback" tax. *See, e.g.*, MD. ASS'N OF CNTYS, FISCAL YEAR 2013, REPORT OF COUNTY BUDGETS, TAX RATES & SELECTED STATISTICS 39 (2013).

[3] Including Maryland, seventeen states had a separately stated local income tax in 2011 but a majority were applicable to only certain localities therein. *See* JOSEPH HENCHMAN & JASON SAPIA, TAX FOUND., FISCAL FACT, NO. 280 (2011).

[4] That the "piggyback" tax for the benefit of Maryland counties and the independent city of Baltimore (considered a county for taxing purposes per Maryland Annotated Code, Tax General, Section 1-101(f)) is in actuality a state tax was first set forth by the Maryland Court of Appeals in *Stern v. Comptroller of the Treasury*, 316 A.2d 240, 240–41 (Md. 1974), prior to the 1975 change in the law designed to prohibit application of the credit against the county tax.

The Comptroller concedes that the county tax is one of two basic components of the State personal income tax.[5] Br. 3. However, Maryland offers its residents only a partial credit against tax on income sourced from another state that is taxed by that source state at a rate higher than that of the "non-piggyback" portion of the Maryland income tax. The failure to offer a full credit violates the dormant Commerce Clause.[6]

II. THE AUTHORITY OF A STATE OR ANY OF ITS POLITICAL SUBDIVISIONS TO TAX THE INCOME OF ITS OWN RESIDENTS IS SUBJECT TO COMMERCE CLAUSE LIMITATIONS.

It is a well-established principle under the Due Process Clause that an individual who avails himself or herself of the services provided by a state, whether by residing in or conducting business within the state, may justifiably be subject to taxation by that state on income derived therein. *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462–63 (1995); *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 279–80 (1932). This is true, provided that there is substantial nexus with the state and that the tax is fairly related

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[5] Notwithstanding that the "county" tax is properly a state tax, quotation marks are avoided herein.

[6] The term "dormant" Commerce Clause, also known as the "negative" Commerce Clause arose from the inference that with the power of Congress to regulate commerce "among the several states" pursuant to Article I, Section 8, Clause 3, of the Constitution came a restriction prohibiting a state from passing legislation that improperly burdens or discriminates against interstate commerce. A doctrine now, the term "dormant" was first used by Chief Justice John Marshall in *Gibbons v. Ogden*, 22 U.S. 1, 189 (1824).

to the services provided by that state. *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 183–84 (1995); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The rationale behind this is that individuals may fairly be expected to contribute to the services and privileges provided to them as a result of residing within a state's borders. *See Chickasaw Nation*, 515 U.S. at 450 (1995).

As a matter of due process, it is without question that the State of Maryland may tax all of the income of its residents (as well as income of nonresidents derived from activities conducted within the State). *See id.*; *Lawrence*, 286 U.S. at 279. This is uncontested in the instant case; the taxpayers in *Wynne* clearly reside within the State of Maryland and surely take advantage of the various services accompanying such residence so that Maryland may fairly collect taxes in order to, in part, pay for those services. While this may be so, it is also true that a state's right to tax the income of its residents based on due process principles is subject to certain limitations.

A state-imposed tax may pass muster under Due Process Clause standards and yet may still unduly burden interstate commerce in a manner that causes it to be unconstitutional under the dormant Commerce Clause. *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 note 7 (1992). Such is the case in *Wynne*.

The Commerce Clause, in affording Congress the right to regulate interstate commerce, has long been held to include a negative component with regard to the rights of individual states. *See Brown v. Maryland*, 25 U.S. 419 (1827). Through its grant of the right to Congress to regulate interstate commerce, the Commerce Clause in turn creates an implicit restraint on the individual states' taxing authority

when the application of a state's tax places an undue burden on interstate commerce. *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330 (2007).

Maryland argues that Commerce Clause limitations should not be applied when the county tax is collected from residents of the State of Maryland, from which it has a right to collect taxes as a result of the services it provides. However, the tax, as applied, negatively impacts interstate commerce. This is so because Maryland places a higher tax burden on its residents who engage in business outside of the State than that imposed on those residents conducting business solely within the State. This encourages Marylanders to keep their business endeavors within the State and "penalizes" those who do not. Such is the type of disproportionate tax treatment that the Commerce Clause is designed to prevent.

By effectively discouraging the resident, or a flow-through entity[7] in which the resident owns an interest, from conducting business outside of the State, the Maryland county tax is indeed negatively impacting the interstate market. As a result, Maryland's county tax places a burden "on the flow of commerce across its borders that commerce wholly within those borders

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[7] Flowthrough entities are those in which income is normally taxed not at the entity level but in which distributive shares of income are taxed to the owners on their own returns. In a business context, partnerships and S corporations are examples of flowthrough entities. *See* Title 26 U.S.C. §§ 701-777, 1361-1379. A multiple owner limited liability company may choose to be taxed as a partnership or S corporation (also as a C corporation), and a single owner limited liability company may choose to be taxed as an S corporation (also as an individual sole proprietorship or C corporation). *See* 26 C.F.R. § 301.7701-3.

would not bear", which is counter to the purpose of the Commerce Clause. *See Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) (quoting *Jefferson Lines*, 514 U.S. at 180). This unequal burden amounts to facial discrimination for dormant Commerce Clause purposes. *See id.*

Maryland would like us to believe that no discrimination exists or that it is irrelevant because it has due process rights to tax its residents. However, this is an oversimplification, as it ignores both the overarching impact of the county tax as well as the limitations to which the State's due process rights are subject under the dormant Commerce Clause when the exercise of those rights interfere with interstate commerce. As a result of this interference, and the facial discrimination that this tax creates, the dormant Commerce Clause is applicable and, thus, the Maryland county tax is subject to dormant Commerce Clause scrutiny.

Even if Maryland's county tax were a true local tax and not a state tax, it would still not be immune from the limitations of the dormant Commerce Clause under the prior holdings of this Court which have recognized that the dormant Commerce Clause applies to local taxes.[8] To illustrate, the most purely local of local taxes in the United States is commonly known as a "property tax" and is imposed on the value of property located within a county, city or other state subdivision. The tax is imposed directly by the local taxing jurisdiction for the benefit of that particular locality. It has been argued that, inasmuch as a

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[8] This Court has also recognized that local taxes are subject to dormant Commerce Clause scrutiny to determine if they interfere with the power of Congress to regulate commerce with foreign nations. *Japan Line, Ltd v. Cnty. of Los Angeles*, 441 U.S. 434, 451–57 (1979).

property tax is imposed at the local level, by the locality, only on property located within that state subdivision taxing jurisdiction, it could not be subject to limitations imposed on interstate commerce. This Court has long seen through this fiction, recognizing that purely local taxes can, and do, have a substantial impact on interstate commerce in this country.

For example, *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564 (1997), involved a church camp for children in the Town of Harrison. The town, like most other towns in this country, imposed a local property tax. Most charities in the Town of Harrison were allowed an exemption from the tax. However, the exemption was only allowed in full if the charity principally benefited residents of Maine. For charities, such as Camps Newfound, that primarily attracted campers from outside of Maine, there was a much more limited exemption from the tax. The Town argued to this Court that the Commerce Clause should not apply to a local real estate tax. This Court responded that "[a] tax on real estate, like any other tax, may impermissibly burden interstate commerce." *Id.* at 574. Emphatically, the Court observed that "[t]he history of our Commerce Clause jurisprudence has shown that even the smallest scale of discrimination can interfere with the project of our federal Union." *Id.* at 595. Similarly, an income tax for the benefit of localities may burden interstate commerce, as in the instant case.

Thus, by any reasoning, Maryland's argument that its county income tax is free from Commerce Clause limitations is seriously misguided. The potential for a disproportionate tax burden being placed on interstate versus intrastate commerce dictates Commerce Clause analysis. This holds true even though the

statute is designed by the State as a county tax, inasmuch as the same activities are also taxed outside of Maryland. The overall effect significantly impacts interstate commerce. *See Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981).

Once it is determined that the dormant Commerce Clause applies to a state tax, the four-part analysis articulated in *Complete Auto Transit* must be applied to determine whether an otherwise acceptable state tax violates the dormant Commerce Clause by placing an undue burden on interstate commerce. 430 U.S. at 279. This test requires that the tax (1) be applied to an activity with a substantial nexus to the taxing state, (2) be fairly apportioned to that activity, (3) is not discriminatory towards interstate or foreign commerce, and (4) is fairly related to services provided by the State. *Id.*

As discussed in further detail below, Maryland's county tax passes the first and fourth requirements but fails with regard to the second and third requisites.

III. THE FAILURE OF MARYLAND TO APPLY THE CREDIT FOR TAXES PAID TO OTHER STATES AGAINST THE "PIGGYBACK" COUNTY INCOME TAX VIOLATES THE COMMERCE CLAUSE BY FAILING TO FAIRLY APPORTION THE INCOME TAX BURDEN AND SUBJECTS MARYLAND RESIDENTS TO SIGNIFICANT DOUBLE TAXATION.

The rationale behind fair apportionment is "to ensure that each State taxes only its fair share of an interstate transaction." *Jefferson Lines*, 514 U.S. at 184; *Goldberg v. Sweet*, 488 U.S. 252, 260–61 (1989).

As far back as the nineteenth century, this Court has upheld the proposition that states cannot burden interstate commerce by taxing gross receipts of an entity that operates in interstate commerce and has suggested that fair apportionment of tax is a constitutional necessity. *See In re State Freight Tax*, 82 U.S. 232 (1872).

In *Maine v. Grand Trunk Railway Co.*, 142 U.S. 217 (1891), the state of Maine was taxing the gross receipts of a railroad that operated among several states. The State was using a formula to compute the value of the tax by multiplying the railway's total receipts by a fraction to estimate the amount of revenue attributable to the state. *Id.* This court upheld the use of a formula as a means of apportioning the tax, identifying "[t]he rule of apportioning the charge to the receipts of the business would seem to be eminently reasonable, and likely to produce the most satisfactory results, both to the State and the corporation taxed." *Id.* at 228.

This Court has further refined the requirement of fair apportionment through the tests of "internal consistency" and "external consistency." The internal and external consistency requirements of the "fair apportionment" test stand for the proposition that the Constitution safeguards residents of a state from multiple taxation stemming from interstate commerce, and that states may only tax the component of the transaction which occurs within that state. *Goldberg*, 488 U.S. at 262.

Internal consistency requires taxes not burden interstate commerce any more than intrastate commerce, and that result must be the same if every state were to impose a tax identical to the tax being

called into question.[9] *Jefferson Lines*, 514 U.S. at 185. The requirement "asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Id.* Thus, the feasibility of the apportionment model is not called into question in the analysis of whether the tax complies with the Commerce Clause requirements. Rather, the fairness of the tax on a national scale is at issue in reviewing internal consistency.

If a state determines its share of the tax base in a manner that is internally consistent, there should be no burden on those operating interstate that is not borne by those who are purely intrastate. *Goldberg*, 488 U.S. at 261. While, in theory, fair apportionment is designed to prevent "multiple taxation", that is to say taxation by multiple states on the same income, this is not always the economic reality. While some risk of duplicate taxation may exist when a taxpayer is taxed by multiple states in which it operates, so long as the state's method of apportionment is fair, it will be upheld. *Moorman Mfg. Co. v. Blair*, 437 U.S. 267 (1978). However, this is limited by the proposition that, while not all burdens on commerce are forbidden, those which are discriminatory will not be upheld. *Nippert v. City of Richmond*, 327 U.S. 416, 425 (1946). The Court there held that:

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[9] Internal consistency is preserved when the imposition of a tax identical to the one in question by every other state would add no burden to interstate commerce that intrastate commerce would not also bear.

> [t]here is no lack of power in the state or its municipalities to see that interstate commerce bears with local trade its fair share of the cost of local government . . . . But this does not mean, and the trends do not signify, that the state or municipal governments may devise a tax applicable to all commerce alike, which strikes down or discriminates against large volumes of that commerce . . . .

Id at 431.

The Maryland tax scheme fails the internal consistency test. Individuals operating purely intrastate pay tax on their entire income, a single time, at the Maryland rate. Those operating in interstate commerce are subject to the tax of both the state where the income is earned as well as the state of residence. This creates a duplicate burden for those operating in interstate commerce, which is not a burden to those operating purely intrastate. Imagined over all fifty states, as the internal consistency test requires, this means any individual operating in interstate commerce would pay tax on 100 percent of his or her income derived in each state—both in the state where the income was earned and then again in the state of residence. Thus, the Maryland tax is not fairly apportioned because it is not internally consistent.

While the limited possibility of a tax creating multiple taxation is not enough to invalidate the tax, that is not the issue with Maryland's county tax. The Maryland county tax allows for no credits to be applied for tax paid on income earned outside Maryland while intending to tax transactions arising from business in other states.

The Maryland tax with its failure to apportion places a burden on those operating in interstate commerce to pay state tax in those states in which the business transactions occur as well as an additional tax on those transactions solely based on the privilege of being residents of the state of Maryland. This tax runs afoul of the often cited rule that a state may not tax value earned outside its borders. *See Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 223 (1980); *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944).

IV. THE FAILURE OF MARYLAND TO APPLY THE CREDIT FOR TAXES PAID TO OTHER STATES AGAINST THE "PIGGY-BACK" COUNTY INCOME TAX HAS A CHILLING EFFECT ON MULTI-STATE PROFESSIONALS AND OTHER BUSINESSES AND DISCRIMINATES AGAINST INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE.

The failure to apply the full credit for taxes paid to other states on income that Maryland is taxing increases the costs of doing business in interstate commerce. This increased cost of doing business across state lines makes doing such business less profitable and therefore less attractive to investors. The result of this additional cost of doing business in more than one state has a chilling effect on individuals involved in multi-state businesses.

Consider the effect on a professional (engineer, certified public accountant, attorney, medical provider, etc.) who is setting up a new business. Assume he or she lives in Maryland but wants to do business in other states as well. That professional, or

the flowthrough entity used, will need to charge higher prices for the work that will be done in other states than practitioners in those states in order to earn the same profit that would be made if doing business only in Maryland. Charging higher prices, just to make the same amount of profit, will tend to reduce the attractiveness of providing those services in the other states. This will tend to discourage people from doing business in more than one state and thus will have a chilling effect on interstate commerce.

The arguments made in Maryland's Reply Brief in its Petition for a Writ of Certiorari at pages 4–6 and in the Solicitor General's Amicus Brief at pages 2–3 that any credits given for taxes paid to another state are gratuitous grants of the State further emphasize that interstate commerce is unduly burdened by the failure of Maryland to give full credit to taxes paid to another state. If that position were upheld by this Court, and other states reacted to eliminate their current systems of granting credits for taxes paid to other states, the impact on interstate commerce could be devastating. The rule against discrimination is to prohibit laws that would "excite those jealousies and retaliatory measures the Constitution was designed to prevent." *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 390 (1994).

So long as some method of ameliorating the detriment of double taxation is employed, the Constitutional bar against undue burden on interstate commerce would not be breached. Credits are not the only means of avoiding discrimination against interstate commerce in the case of multi-state professionals and other businesses. When income is earned in interstate commerce by a "regular" or

C corporation[10] taxed at the entity level, discrimination is avoided by apportioning the income among the states involved.[11] When income is earned in interstate commerce by an individual (either directly or through a flowthrough entity), discrimination is avoided by the state of residence granting a credit for the tax paid to the other states.[12]

It should not matter as to what type of entity earned the interstate income, whether a C corporation, a flowthrough entity or an individual. The earner is entitled to enjoy protection from discrimination under the Commerce Clause.

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[10] *See* Title 26 U.S.C. §§ 301-385.

[11] Individuals taxed as sole proprietors and those receiving income from flowthrough entities enjoy protection from discrimination by apportionment of income among all states other than that of residence.

[12] States of corporate domicile do not seek to tax all income of a corporation as do states of individual residence.

CONCLUSION

For the foregoing reasons, the Court should affirm the decision of the Maryland Court of Appeals.

Respectfully submitted,

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September 26, 2014

AMICUS CURIAE BRIEF

No. 13-485

IN THE

Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
Petitioner,

v.

BRIAN WYNNE, *ET UX.*
Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST [1]

The American Legislative Exchange Council (ALEC) is the nation's largest non-partisan individual membership association of state legislators. ALEC has approximately 2,000 members in state legislatures across the United States. The American Legislative Exchange Council works to advance limited government, free markets and federalism at the state level through a nonpartisan public-private partnership of America's state legislators, members of the private sector and the general public.

ALEC believes that power dynamics between states require careful consideration. This includes the fundamental principle of equal state sovereignty. The power to tax is a necessary incident of state sovereignty. When interstate commercial transactions are at issue, a principled approach is needed that affirms sovereign equality of states to tax while reconciling potential conflicts between state taxing powers and preventing undue burdens on such transactions.

According to the *ALEC Principles of Taxation*, states that follow certain fundamentals of tax policy are more likely to produce economic growth while minimizing political favoritism by state taxing authorities. Among other things, "[a]n effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation

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[1] No counsel for any party authored this brief in whole or in part and no entity or person, aside from amicus curiae, their members, and their counsel, made any monetary contribution toward the preparation or submission of this brief. Counsel of record for all parties have consented to this filing in letters on file with the Clerk's office.

through tax pyramiding."[2] A tax system premised on equity and fairness should not be used to "engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers."[3]

ALEC believes state tax policy should also be guided by the principle of competitiveness:

> A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies.[4]

ALEC recognizes that states are rivals in an interstate competition for jobs and growth. As ALEC policy acknowledges, "state legislatures have designed their individual state tax structure to meet the needs of their in-state businesses, thereby distinguishing their state from, and competing directly with, other states."[5] ALEC has also published *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index* to

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[2] ALEC, *ALEC Principles of Taxation* (2010), *available at*: http://www.alec.org/model-legislation/statement-alec-principles-of-taxation/.

[3] *Id.*

[4] *Id.*

[5] ALEC, *Resolution to Oppose the Multistate Tax Commission's Effort to Rewrite the Uniform Division of Income for Tax Purposes Act* (2014), *available at*: http://www.alec.org/model-legislation/resolution-oppose-multistate-tax-commissions-effort-rewrite-uniform-division-income-tax-purposes-act/.

highlight the importance of state taxation policy in assessing state economic competitiveness. [6]

It is ALEC's view that a fair apportionment requirement, such as the one expressed in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), is necessary to protect the taxing power of equal sovereign states. Fair apportionment also safeguards interstate tax competition by limiting multiple taxation of interstate commerce and by checking unjustifiable extraterritorial state taxation.

The purpose behind fair apportionment is *not* to limit the taxing powers of states as such. Nor is the purpose to reduce taxing powers in the states vis-à-vis the federal government. Ultimately, the purpose of fair apportionment is to reconcile the concurrent taxing authority of all states regarding interstate commercial transactions.

SUMMARY OF ARGUMENT

The American Legislative Exchange Council believes the Court of Appeals of Maryland correctly applied the requirement that a state's taxation of interstate commercial transactions be fairly apportioned to those activities in the state taxing jurisdiction. *See Maryland State Comptroller of Treasury v. Wynne*, 64 A.3d 453 (Md. 2013). *Amicus* offers this brief to address how federalism's system of political sovereignty and political economy is implicated in the fair apportionment requirement set

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[6] *See* Arthur B. Laffer, Stephen Moore & Jonathan Williams, *Rich States Poor States: ALEC-Laffer State Economic Competitiveness Index* (7th ed.) (2014), *available at*: http://alec.org/docs/RSPS_7th_Edition.pdf.

out by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

First, fair apportionment comports with federalism's system of political sovereignty by ensuring the harmonious concurrent exercise of state taxing power over interstate commerce. The Constitution's structure and this Court's jurisprudence recognize the fundamental principle of equal sovereignty among states. *Shelby County, Alabama v. Holder*, — U.S. —, 133 S.Ct. 2612, 2623 (2013). The equal sovereignty of the states generally prohibits states from imposing their own laws and taxes on their sister states. *See, e.g., ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). This fundamental principle is an underpinning of the Court's dormant Commerce Clause jurisprudence, in particular. *Healy v. Beer Institute*, 491 U.S. 324, 335-336 (1989). An unfair apportionment of taxing revenue from interstate commercial transactions to one state at the expense of another state constitutes a particularly odious burden on interstate commerce. In important respects, the fundamental principle of equal state sovereignty is safeguarded by the requirement of fair apportionment of state taxation of interstate commerce. Fair apportionment reconciles the sovereign taxing power of states over interstate commerce by prohibiting impermissible extraterritorial state taxation. Fair apportionment also restricts excessive, multiple taxation of interstate transactions.

Second, fair apportionment comports with federalism's system of political economy by safeguarding interstate tax competition. In today's dynamic world of increasingly mobile capital, businesses, and people, states are in competition with one another to provide the best economic climate possible to foster economic

growth. This economic competition between the states is one of the ingenious by-products of our federalist system.

States frequently vie with one another to have the most tax friendly environment to attract new residents and businesses to move to or conduct business in their state. This is especially true for those states with structural disadvantages such as poor climate, limited natural resources, or no access to ports, for whom the tax code is an invaluable tool to compete with other states. Over the years, the differentiation in state tax rates has had a staggering influence on our nation's demographics and the state's economic growth.

The Court's "external consistency" test for analyzing fair apportionment of state taxation of interstate commerce properly limits states taxing powers to their own respective jurisdictions. *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 US. 175, 185 (1995). Under the external consistency test, the Court considers whether the state has taxed only that portion of revenues from interstate activity that reasonably reflects its in-state component. *Id.* It ensures states only tax the value of interstate commercial transactions properly attributable to them. Under the external consistency test, taxation of an amount beyond the state's fair share of the interstate commercial activity involved is an impermissible form of extraterritorial taxation. By restricting states from making unwarranted tax grabs from interstate commerce, the fair apportionment requirement helps preserve the ability of states to establish their own competitive marketplaces.

In addition, the Court's "internal consistency" test for analyzing fair apportionment, directed at multiple taxation on interstate commerce, safeguards

interstate tax competition. *Id.* Under the internal consistency test, the Court considers whether the tax at issue, if applied by every state, would disadvantage interstate commerce. *Id.* Multiple taxation harms both states with economically hospitable tax environments and those that do not impose double taxation. The competitiveness of tax-friendly states is undermined to the extent their sister states impose multiple taxes on interstate commercial activities and show favoritism toward in-state commerce.

ARGUMENT

I. THE REQUIREMENT THAT TAXES ON INTERSTATE COMMMERCE BE FAIRLY APPORTIONED TO TAXPAYERS' ACTIVITIES IN THE TAXING STATE SAFEGUARDS STATE EQUALITY AND STATE TAX COMPETITION

Important federalism concerns of both a constitutional and practical nature are implicated by the requirement that a state's taxation of interstate commercial transactions be fairly apportioned to those activities in the state taxing jurisdiction.

Under the test set out in the leading case of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, (1977), a state tax will survive a challenge under the dormant Commerce Clause if it: (1) applies to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) is not discriminatory towards interstate or foreign commerce; and (4) is fairly related to the services provided by the State. *Id.* at 279.

As will be briefly explored below, fair apportionment comports with federalism's system of political

sovereignty by ensuring the harmonious concurrent exercise of state taxing power over interstate commerce. In addition, fair apportionment comports with federalism's system of political economy by ensuring interstate tax competition through limits on multiple taxation and extraterritorial taxation.

A. The Doctrine of State Equality Implies that States May Only Tax Their Fair Share of Interstate Commercial Transactions

1. The Equal Sovereignty of States is a Fundamental Principle of the Constitution

"[T]he Constitution, in all of its provisions, looks to an indestructible Union, composed of indestructible States." *Texas v. White*, 74 U.S. (7 Wall.) 700, 725 (1869). The States entered the Union as equal sovereigns, and they retain their equal status under the Constitution. "'This Union' was and is a union of States, equal in power, dignity and authority, each competent to exert that residuum of sovereignty not delegated to the United States by the Constitution itself." *Coyle v. Smith*, 221 U.S. 559, 567 (1911).

Implied in the Constitution's basic structure and reflected in this Court's jurisprudence is the "'fundamental principle of *equal* sovereignty'" among the States." *Shelby County, Alabama v. Holder*, — U.S. —, 133 S.Ct. 2612, 2623 (2013); *Northwest Austin Municipal Utility Dist. Number One v. Holder*, 557 U.S. 193, 203, (2009) (citing *United States v. Louisiana*, 363 U.S. 1, 16, (1960); *Lessee of Pollard v. Hagan*, 44 U.S. (3 How.) 212, 223, (1845); and *White*, 74 U.S. (7 Wall.) at 725-726) (emphasis added). Indeed, "the constitutional equality of the States is

essential to the harmonious operation of the scheme upon which the Republic was organized." *Shelby County*, 133 S.Ct. at 2623; *Coyle*, 22 U.S. at 580.

On the one hand, the equal sovereignty of states generally prohibits federal legislation that differentiates between the states. *Holder*, 557 U.S. at 203; *South Carolina v. Katzenbach*, 383 U.S. 301 328-329 (1966). Justification must therefore be supplied for departing from the requirement that states be treated alike, since "the fundamental principle of equal sovereignty [is] highly pertinent in assessing subsequent disparate treatment of States." *Shelby County*, 133 S.Ct. at 2623; *Holder*, 557 U.S. at 203.

On the other hand, the equal sovereignty of the states generally prohibits states from imposing their own laws and taxes on their sister states. *See, e.g.*, *BMW of N. Am. Inc. v. Gore*, 517 U.S. 559, 571 (1996) ("No state could . . . impose its own policy choice on neighboring states."); *Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881) ("No state can legislate except with reference to its own jurisdiction . . . Each state is independent of all the others in this particular"); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982) ("As a general principle, a state may not tax value earned outside its borders").

2. *The Equal Sovereignty of States Informs Dormant Commerce Clause Limits on State Taxation*

This case turns upon principles and considerations addressed by this Court's dormant Commerce Clause jurisprudence. The Constitution's fundamental principle of equal state sovereignty is an underpinning of that jurisprudence. *Healy v. Beer Institute*, 491 U.S. 324, 335-336 (1989) (the Constitution has a "special

concern with both the maintenance of a national economic union unfettered by state-imposed limitations on interstate commerce and with autonomy of the individual States within their respective spheres"); *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 775 (1945) (striking down a state law on Commerce Clause grounds where the "practical effect of such regulation is to control [conduct] beyond the boundaries of the state..."). Whenever State A asserts its taxing authority over interstate commercial transactions in which State B already has an equal or stronger connection for taxing purposes, there is a risk of State A encroaching upon the sovereignty of State B. An unfair apportionment of taxing revenue from interstate commercial transactions to one state at the expense of another state constitutes a particularly odious burden on interstate commerce.

3. *Fair Apportionment is Necessary to Reconcile Potentially Conflicting Exercises of Taxing Power by Equal Sovereign States*

When interstate commerce is involved, the sovereign powers of states to tax may clash. The power to tax is an inherent incident of state sovereignty. *See M'Culloch v. Maryland* at 4 (Wheat) U.S. 316, 329 (1819). The equal sovereignty of states therefore requires that each continue to exercise their own respective powers to tax while nonetheless remaining free from undue interference by other states' tax policies. In important respects, the fundamental principle of equal state sovereignty is safeguarded by the requirement of fair apportionment of state taxation of interstate commerce.

"The central purpose behind the apportionment requirement is to ensure that each State taxes only its

fair share of an interstate transaction." *Goldberg v. Sweet*, 488 U.S. 252, 260-261 (1989) (citing *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983)). As the Court explained in *Trinova Corp. v. Dept. of Treasury*, the Commerce Clause prohibits the "competitive mischief" posed by "the opportunity for a state to export tax burdens and import tax revenues" where no justification for apportionment exists. 498 U.S. 358 374 (1991). Fair apportionment thereby reconciles the sovereign taxing power of states over interstate commerce by prohibiting impermissible extraterritorial state taxation. Fair apportionment also restricts excessive, multiple taxation of interstate transactions. Indeed, "[t]his principle of fair share is the lineal descendant of *Western Live Stock* [*v. Bureau of Rev.*]'s prohibition of multiple taxation, which is threatened whenever one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it." *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 US. 175, 184-185 (1995) (citing 303 U.S. 250 (1938)). The fair share principle ensures each equal sovereign state receives nothing more or less than its fair share of tax revenues.

Accordingly, to the extent certain *amici* contend that the test set out in *Complete Auto Transit* does not apply, Multistate Tax Comm'n Br. at 7, 10-11; Int'l Municipal Lawyers Assoc. *et al.* Br. at 24-26, ALEC believes they are mistaken in their reading of this Court's jurisprudence and doubly mistaken in disregarding the principle of sovereign state equality that is safeguarded by the fair apportionment

requirement. *See, e.g.*, Int'l Municipal Lawyers Assoc. *et al.* Br. at 6, 21-22.

Finally, ALEC is aware of thoughtful skepticism that has been voiced with respect to this Court's dormant Commerce Clause jurisprudence, and it formulation of the *Complete Auto Transit* test. *See, e.g., Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 610-620 (1997) (Thomas, J., dissenting); *Jefferson Lines*, 514 US. at 200-201 (Scalia, J., concurring in judgment). To the extent that skepticism over all or parts of this Court's dormant Commerce Clause jurisprudence remains, ALEC respectfully submits that the fundamental principle of state sovereign equality offers a stand-alone basis for a workable fair apportionment requirement of state taxation of interstate commerce.

B. The Ability of States to Pursue Competitive, Tax-Friendly Economic Climates Requires that States Only Tax Their Fair Share of Interstate Commercial Transactions

1. Interstate Tax Competition is a Critical Aspect of Interstate Commerce

In today's dynamic world of increasingly mobile capital, businesses and people, states are in competition with one another to provide the best economic climate possible to foster economic growth. This economic competition between the states is one of the ingenious by-products of our federalist system.

States frequently vie with one another to have the most tax-friendly environment to attract new residents and businesses to move to or conduct business in their state. This is especially true for those states with structural disadvantages such as poor

climate, limited natural resources or no access to ports, for whom the tax code is an invaluable tool to compete with other states. Over the years, the differentiation in state tax rates has had a staggering influence on our nation's demographics and the state's economic growth.

In *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*, Arthur B. Laffer, Stephen Moore and Jonathan Williams examined population movements across state boarders by a number of measures and also examined how those movements related to state economic climates and pro-growth tax and fiscal policies. Looking at adjusted gross income figures, for example, the authors cited Travis Brown, author of *How Money Walks*. According to Brown, $2.2 trillion dollars in adjusted gross income has migrated from one state to another from 1992 to 2011.[7] In addition, according to IRS tax return filing data regarding net domestic migration, during that same time period roughly 62 million taxpayers moved from one state to another.[8] By means of extensive statistical analysis, the authoring economists of *Rich States, Poor States* demonstrate that these migrations are strongly connected with tax policy, and that billions of dollars and millions of Americans have fled higher tax states for those with more tax-friendly climates.

Although there are many factors contributing to a state's economy which cannot be managed, tax and fiscal policy factors are solidly in the control of the state's policymakers. A state cannot vote for warmer weather, more oil reserves or a nice coastline, but

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[7] *Id.* at 22.

[8] *Id.*

policymakers can make sure that there is more capital in the hands of businesses and citizens, and can make it easier for them to save, earn and invest.

2. *Interstate Tax Competition is Safeguarded by Fair Apportionment Restrictions on Multiple and Extraterritorial Taxation*

The requirement that state taxation of interstate commercial transactions be fairly apportioned to activities within the taxing state safeguards interstate tax competition. This can be most readily seen with regards to the fair apportionment analytical test for external consistency, which addresses impermissible exterritorial taxation.

This Court "determine[s] whether a tax is fairly apportioned by examining whether it is internally and externally consistent." *Goldberg*, 488 U.S. at 261. The "internal consistency" test, "simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Jefferson Lines*, 514 U.S. at 185.

"The external consistency test asks whether the state has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 462. In analyzing whether a state tax on interstate commerce is externally consistent, the Court "looks not to the logical consequences of cloning, but to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity

within the taxing state." *Jefferson Lines*, 514 U.S. at 185.

In effect, the external consistency test confines the states' taxing powers to their own respective jurisdictions. It ensures that states will only tax the value of interstate commercial transactions to the extent that they are properly attributable to them. Under the external consistency test, taxation of an amount beyond the state's fair share of the interstate commercial activity involved is an impermissible form of extraterritorial taxation.

The viability of interstate tax competition depends upon states' autonomy to pursue pro-growth, tax-friendly policies without having that autonomy being subverted by foreign state taxing authorities seeking lucrative sources of revenue. Extraterritorial state taxation undermines the ability of other states to exercise their own taxing powers in ways that attract capital investors, entrepreneurs, innovators and other growth and job creators.

By restricting states from making unwarranted tax grabs from interstate commerce, the fair apportionment requirement helps preserve the ability of states to establish their own competitive marketplaces. The external consistency test helps guarantee states may pursue pro-growth, tax-friendly policies free from undue interference by extraterritorial state tax adventurism.

Of course, the "internal consistency" test, which is directed at multiple taxation on interstate commerce, also provides a safeguard function for interstate tax competition. As mentioned above, under the internal consistency test, the Court considers whether the tax at issue, if applied by every state, would put

interstate commerce at a disadvantage vis-à-vis intrastate commerce. *See Jefferson Lines*, 514 U.S. at 185.

If every state were to tax its residents full income, wherever earned, without a *full* tax credit for income taxes already paid to other states, as Maryland does, interstate commerce would be placed at a significant disadvantage compared to intrastate commerce. This would result in a profound negative effect on the national economy. In the absence of such double taxation, individual workers and owners of S corporations are unhindered from operating in their home state, or in other states, as they find to be most productive, while taking into account the various tax rates on personal income that states offer to compete for their labor and business. This efficiency maximizes their benefit to society in terms of goods and services provided to the public, their personal income and, for S corporations, their profitability and potential for job creation.

However, if every state provided less than full tax credits for personal income paid to other states, workers and owners of S corporations would face double taxation whenever they engage in interstate commerce. The incentive would be for them to keep their activities within the confines of their state and avoid double taxation, producing a chilling effect on interstate commerce. Decisions to work across state lines or open new locations in other states would all carry significant additional tax penalties that would artificially divert workers and S corporations from making what would otherwise be the best economic decisions. As an effect, profitability would decrease, job creation would be slowed and the availability of out of state labor, products and services to those living in the rest of the country would be diminished. This

reduction in competition in the national marketplace will lead to less choice for consumers and increased costs of products and services.

In short, the adoption of Maryland's double taxation nationwide would result in much more intrastate commerce, at the expense of far less interstate commerce, and lead to tremendous economic disruption and inefficiency. This would be devastating for all Americans because all Americans benefit from interstate commerce, not just those who earn income from multi-state S corporations like the Wynne's.

On a state level, multiple taxation harms both those states that have adopted economically hospitable tax environments and those that do not themselves double tax resident income by failing to provide a full tax credit for income taxes paid to other states. Where commerce is subject to extra taxation simply because it crosses state lines, tax-friendly states lose out of state workers and business opportunities from other states. Some who used to drive across state lines to do some work in another state will stop, certain businesses that wanted to open a branch in the neighboring state won't, and the tax friendly state will suffer the ill effects of its neighbor's double taxation.

While citizens and businesses can and do "vote with their feet" and re-locate to states with more hospitable tax climates, the competitiveness of those tax-friendly states is undermined to the extent their sister states impose multiple taxes on interstate commercial activities and thereby act with favoritism toward in-state commerce. *See New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273-274 (1988) ("[t]he modern law of what has come to be called the dormant Commerce Clause is driven by concern about

'economic protectionism'—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.")

CONCLUSION

For the reasons set forth above, *amicus curiae* American Legislative Exchange Council respectfully requests that the Court affirm the decision of the Maryland Court of Appeals.

Respectfully submitted,

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AMICUS CURIAE BRIEF

No. 13-485

IN THE

Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

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QUESTION PRESENTED

Whether a state tax that exposes interstate commerce to double taxation is saved from invalidation under the Commerce Clause merely because the State imposes the tax upon its own residents.

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IN THE

Supreme Court of the United States

NO. 13-485

MARYLAND STATE COMPTROLLER OF THE TREASURY,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

INTEREST OF *AMICUS CURIAE*

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation.[1] The Chamber represents an underlying

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[1] This brief is filed with the consent of the parties, and letters of consent have been filed with the Court. Pursuant to this Court's Rule 37.6, *amicus* affirms that no counsel for a party authored this brief in whole or in part, that no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief, and that no person other than *amicus*, its members, or its counsel made such a monetary contribution.

membership of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus* briefs in cases that raise issues of vital concern to the Nation's business community.

The Chamber's members are engaged in commerce in and among each of the 50 States and are subject to a wide variety of state taxes and other regulations. As a result, state tax and regulatory schemes can have significant impacts on their business objectives—and, in particular, on their interstate activities. The Chamber has filed *amicus* briefs in other cases involving issues of state taxation and the Commerce Clause. It is, as a result, uniquely suited to offer a business perspective on these issues and keenly interested in ensuring that state taxes and other regulations are consistent with the Commerce Clause.

SUMMARY OF ARGUMENT

The national economy is dependent on the free movement of goods and services throughout the country. That idea is embedded in the Constitution's Commerce Clause and is effectuated, in part, by the prohibition on multiple taxation by different States of income earned through interstate commerce. In order to prevent the "barriers to interstate trade" that such taxation would create, *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 256 (1938), States must fairly apportion taxes levied on residents' out-of-state income. Maryland employs a tax scheme that fails to fairly apportion such taxes and therefore violates the Commerce Clause. Specifically, Mary-

land taxes its residents on income earned in other States but refuses to provide those residents with a full credit for the taxes on that income paid to the other States. That tax scheme is inconsistent with the principle of unimpeded interstate commerce protected by the Commerce Clause.

I.A. This Court has long recognized that Congress's power to regulate interstate commerce limits the ability of multiple States to tax the same interstate transaction. To avoid multiple taxation, States are required to fairly apportion the tax base of multistate corporations among the States in which the corporations do business. Thus, while States have the sovereign power to tax both income earned by their residents and income earned within their borders by residents and nonresidents alike, when a corporation is doing business in multiple States, that power is necessarily limited. States must implement a tax scheme that meets the "double demand that interstate business shall pay its way, and that at the same time it shall not be burdened with cumulative exactions which are not similarly laid on local business." *Western Live Stock*, 303 U.S. at 258. Consistent with this Court's practical, functional approach to the Commerce Clause, a State can meet the fair apportionment requirement in a variety of ways, such as by employing a formula to calculate its fair share of an interstate transaction or providing taxpayers with credits to offset taxes paid to other States.

B. Although this Court's cases developing the fair apportionment requirement involved C Corporations (with separate tax status), that requirement also applies to taxation of S Corporations (with "pass-through" tax status) and individuals. This Court imposed the fair apportionment requirement to minimize the risk of multiple

taxation and to ensure that a State taxes only its fair share of an interstate transaction. Those principles focus on the interstate transaction itself, not the nature of the taxpayer engaged in the transaction, and they are implicated by the taxation of S Corporations and individuals. Moreover, unapportioned taxation of S Corporations and individuals implicates the Commerce Clause's purpose of preventing States from interfering with interstate commerce and reducing economic efficiency. States thus must fairly apportion the tax bases of S Corporations and individuals just as they must do for C Corporations.

C. To determine whether a state tax meets the fair apportionment requirement, this Court assesses whether the tax is both internally and externally consistent. Maryland's tax scheme fails both tests. It is internally inconsistent because, if it were imposed by every State in the country, it would expose interstate commerce to multiple taxation, thereby inhibiting interstate commerce. It is also externally inconsistent because it taxes income earned in other States, "reach[ing] beyond that portion of value that is fairly attributable to economic activity within" its borders. *Oklahoma Tax Comm'n* v. *Jefferson Lines*, 514 U.S. 175, 185 (1995), superseded in part by statute as recognized by *Jalbert Leasing, Inc.* v. *Massachusetts Port Auth.*, 449 F.3d 1, 3 (1st Cir. 2006). Such overreaching both unfairly benefits Maryland, which is taxing income earned in other States that are providing the market and local services that enable the generation of such income, and impermissibly burdens interstate commerce.

II.A. Maryland's tax scheme, and the rule on which the Comptroller relies to defend it, threatens grave harm to the national economy. The tax scheme obstructs the free flow of business and capital across Maryland's bor-

ders, such that nationwide adoption of this scheme would stifle business growth and damage the national economy.

B. The Comptroller's attempt to defend the tax scheme as a tax based on "residency" fails. This Court's precedents show that the residency of the taxpayer is irrelevant when determining whether a tax discriminates against interstate commerce. The Comptroller's argument also employs the sort of formalistic analysis this Court rejected in this context more than thirty-five years ago. A State cannot evade review under the Commerce Clause by labeling a regulation as a mere local price control. *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186, 201-202 (1994). In the same way, a State cannot justify a taxation scheme that inhibits the flow of capital beyond its borders by labeling it a mere tax on residency. More importantly, the logical extension of the Comptroller's reasoning would permit multiple taxation of any interstate transaction so long as the tax imposed is supposedly based on residency, including taxes this Court has previously found to violate the Commerce Clause.

C. Maryland's tax scheme penalizes businesses for seeking to expand outside of the State's borders. That result is akin to, and just as troubling as, States' efforts to block businesses from *entering* their markets that this Court has found violate the Commerce Clause. In both instances, States are prohibited from obstructing commerce from crossing their borders.

ARGUMENT

Every day, millions of Americans and American businesses produce, use, and enjoy goods and services that originated in another State. The Nation's economy, and everyone's economic interests, are more integrated and interdependent than ever before. At the time of the Framing, even prominent Americans like Abigail Adams

of Massachusetts could sensibly think of Pennsylvania as "'that far country,' unimaginably distant." David McCullough, *John Adams* 20 (2001). Back then, travel was arduous and slow; logistical and technological limitations made shipping goods even a short distance a tremendous challenge. Today, by contrast, it passes virtually unnoticed that a Philadelphia business can take orders from customers in Boston and have the product delivered for pickup at its Worcester outlet the next day. Likewise, goods can be manufactured in California, using parts produced in Texas, and shipped to stores in Times Square almost effortlessly. In 2011, $5.5 trillion in goods were shipped in the United States. See U.S. Census Bureau, *Benchmark Data for Shipments for M3 Industry Categories: 2009-2011*, http://www.census.gov/manufacturing/m3/bench/annualdata.xls. And all indications are that the importance of interstate commerce to the national economy will only continue to grow.

That ever-growing integration benefits all Americans. But it brings with it a concomitant danger that state-erected barriers to the free flow of goods, services, and capital will damage the overall health of our economy. The Maryland tax scheme at issue here poses precisely that kind of threat. It subjects Maryland residents to double taxation on income derived from out-of-state sources without any effort to apportion the tax to Maryland's contribution to the income. That regime imposes an impermissible burden on corporations and individuals who do business across State lines and was properly rejected by the decision below.

I. THE MARYLAND TAX BURDENS INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE BECAUSE IT IS NOT FAIRLY APPORTIONED

This Court has repeatedly held that the Commerce Clause prohibits state taxes that burden interstate commerce by imposing multiple taxation on income earned outside a taxpayer's home State. This Court thus requires that state taxes imposed on interstate activities be fairly apportioned to the in-state component of those activities. Maryland's tax scheme fails that requirement.

A. The Commerce Clause Requires States To Fairly Apportion the Tax Base of Multistate Corporations

While the States have undoubted power to tax income, their authority is limited by Congress's exclusive authority over interstate commerce. As this Court explained more than 150 years ago, the Commerce Clause prohibits "the taxing power of the States" from "interfer[ing] with any regulation of commerce." *Brown* v. *Maryland*, 25 U.S. (12 Wheat.) 419, 448-449 (1827). This case concerns one particularly problematic interference with interstate commerce—efforts to subject interstate transactions and income to taxation by multiple States. "[L]ocal taxes, measured by gross receipts from interstate commerce, have often been pronounced unconstitutional" under the Commerce Clause. *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 255 (1938). The tax at issue here should be no different.

1. *State Efforts To Tax Gross Proceeds from Interstate Sources Impermissibly Burden and Discriminate Against Interstate Commerce*

The threat of multiple taxation arises when multiple States attempt to tax the same transaction by a corporation that does business across state lines. This Court ex-

plained the threat posed by such efforts in *Western Live Stock*. If left unchecked, such taxes would be "imposed * * * with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce." 303 U.S. at 255-256. Allowing multiple States to tax "the gross receipts from interstate transactions would spell the destruction of interstate commerce and renew the barriers to interstate trade" that the Commerce Clause was designed to tear down. *Ibid.*

As a result, this Court has not hesitated to strike down state tax regimes that, because they act on gross income, expose corporations to duplicate taxation on out-of-state income. For example, in *J.D. Adams Manufacturing Co. v. Storen*, 304 U.S. 307 (1938), this Court invalidated an Indiana tax on the "gross income of every resident of the State and the gross income of every nonresident derived from sources within the State." *Id.* at 308. The petitioner, a resident corporation, manufactured and sold road machinery, and most of its customers were outside of Indiana. *Id.* at 308-309. This Court struck down the tax as unconstitutional because it applied to *all* of the corporation's income, no matter its source, thereby exposing income earned out of state to the threat of multiple taxation—once by Indiana and again by the States where the corporation's customers were located. *Id.* at 311-312. The "vice of the statute," this Court held, was "that the tax include[d] in its measure, without apportionment, receipts derived from activities in interstate commerce." *Id.* at 311. Because receipts from interstate sales could be taxed by both the State where the goods were manufactured and the State where the goods were sold, "[i]nterstate commerce would * * * be subjected to the

risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids." *Ibid.*

The Court has repeatedly applied that prohibition on multiple taxation to different types of state taxes, including gross receipts taxes, property taxes, and income taxes. See, *e.g.*, *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U.S. 653 (1948) (gross receipts tax); *Standard Oil Co.* v. *Peck*, 342 U.S. 382 (1952) (property tax); *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983) (income tax). This Court has recognized that States have sovereign power to tax both income earned by their residents (whether earned in or out of state) and income earned within their borders (whether by residents or nonresidents). *Schaffer* v. *Carter*, 252 U.S. 37, 57 (1920). But when a corporation earns income in multiple States, the Commerce Clause prohibits States from subjecting the same corporate income to multiple taxes in different States. In other words, States can require "that interstate business shall pay its way"—the Constitution does not give interstate businesses a "free ride" simply because they operate interstate—but interstate commerce cannot "be burdened with cumulative exactions which are not similarly laid on local business." *Western Live Stock*, 303 U.S. at 258.

Such burdens are particularly damaging in today's integrated economy. Just as consumers have the choice of goods from multiple States, businesses have the choice to establish themselves in multiple States. Even in the field of distinctly local services like restaurants, national enterprises now compete with local business. But with that increase in interstate commerce comes increased risk that States will—intentionally or by neglect—burden interstate commerce to the benefit of local interests. Indis-

criminate taxation of income from out-of-state transactions represents precisely such a threat. The Commerce Clause prevents States from placing a thumb on the scale in favor of local interests, whether through burdens on businesses attempting to enter the State or on those who would take capital out of it.

2. *The Court Requires Fair Apportionment To Avoid Impermissible Burdens and Discrimination Against Interstate Commerce*

To ensure adherence to the prohibition on multiple taxation—while respecting legitimate taxing authority—this Court has upheld state taxes touching on interstate activities where the States "fairly apportion" their taxes to in-state activities. Such apportionment in effect divides multistate corporate tax liability among the States in fair proportion to in-state conduct. See, *e.g.*, *Oklahoma Tax Comm'n* v. *Jefferson Lines, Inc.*, 514 U.S. 175 (1995); *Container Corp.*, 463 U.S. 159; *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267 (1978); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977); *Central Greyhound*, 334 U.S. 653.

In *Complete Auto*, the Court formulated a four-part test to determine whether a state tax violates the Commerce Clause, with the fair apportionment requirement at issue here as the second step. *Complete Auto*, 430 U.S. at 279.[2] The Court has since developed two further in-

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[2] That four-part test is now applied whenever a state tax of almost any kind is challenged on Commerce Clause grounds. See, *e.g.*, *Goldberg* v. *Sweet*, 488 U.S. 252 (1989) (tax on telephone calls); *Container Corp.*, 463 U.S. 159 (franchise tax); *Jefferson Lines*, 514 U.S. 175 (sales tax on bus tickets); *D.H. Holmes Co.* v. *McNamara*, 486 U.S. 24 (1988) (use tax); *Wardair Canada Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1 (1986) (sales tax on fuel used in international commerce); *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609

quiries to implement the fair apportionment requirement. First, state taxes must be "internally consistent," such that "no multiple taxation would result" if an identical tax were imposed by every State. *Goldberg* v. *Sweet*, 488 U.S. 252, 261 (1989). Second, the state tax must be "externally consistent," such that it reaches only the "value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines*, 514 U.S. at 185.

The Court has declined to prescribe a single approach to fair apportionment. States are free to employ a variety of formulas to divide a corporation's tax liability among the States in which the corporation does business. See *Moorman Mfg.*, 437 U.S. at 276-280 (describing different formulas used by various States). States also avoid impermissible multiple taxation by offering tax credits for taxes paid to other States, see *Tyler Pipe Indus.* v. *Washington State Dep't of Revenue*, 483 U.S. 232, 245 n.13 (1987) (tax credits can "alleviate or eliminate the potential multiple taxation that results when two or more sovereigns have jurisdiction to tax parts of the same chain of commercial events"), or reciprocally recognizing payments made to other States, see *American Trucking Assoc., Inc.* v. *Scheiner*, 483 U.S. 266, 283 (1987) (reciprocal treatment of other States' vehicle registration fees ensures that "the Commerce Clause is not offended" because "state boundaries are economically irrelevant"). States thus have considerable flexibility in meeting the fair apportionment requirement. But they cannot create

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(1981) (severance tax); *Mobil Oil Corp.* v. *Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980) (corporate income tax); *Washington Dep't of Revenue* v. *Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734 (1978) (business and occupation tax).

a scheme that systematically exposes interstate transactions to multiple taxation.

The flexibility of the fair apportionment test flows from the Court's broader Commerce Clause jurisprudence, which has repeatedly emphasized the need for a practical, functional analysis of state regulations. As this Court explained in *West Lynn Creamery, Inc.* v. *Healy*:

> Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce. Rather our cases have eschewed formalism for a sensitive, case-by-case analysis of purposes and effects. As the Court declared over 50 years ago: "The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce."

512 U.S. 186, 201-202 (1994) (quoting *Best & Co.* v. *Maxwell*, 311 U.S. 454, 455-456 (1940)); see also *Baldwin* v. *GAF Seelig, Inc.*, 294 U.S. 511, 527 (1935) ("What is ultimate is the principle that one state in its dealings with another may not put itself in a position of economic isolation. Formulas and catchwords are subordinate to this overmastering requirement.").

B. The Fair Apportionment Requirement Should Apply to S Corporations and Individuals

This Court's cases developing the fair apportionment requirement generally involved so-called "C Corporations"—corporations that are subject to taxation separately from their owners. See *Goldberg*, 488 U.S. at 261 (collecting cases). But the same principles that give rise to the prohibition on multiple taxation of C Corporations

also support a rule against multiple taxation of S Corporations and individuals. Such a rule properly applies to all persons and entities engaged in interstate commerce that are threatened with overlapping state taxes that disadvantage their interstate activities.[3]

The Court's prohibition on multiple taxation is based on a recognition of the unassailable fact that multiple taxation "discriminates against interstate commerce." *Gwin, White & Prince, Inc.* v. *Henneford*, 305 U.S. 434, 438 (1939). And a tax does so if "it imposes upon [interstate commerce], merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed." *Id.* at 439. That disparate burden is, of course, felt acutely by multistate C Corporations, which are themselves subject to taxation. They may confront multiple taxation of a single transaction that a company doing business in only one State would not. But the same is true for interstate S corporations and individuals engaging in the same transactions.

Moreover, because the Commerce Clause prohibits a State from taxing more than "its fair share of an *interstate transaction*," *Goldberg*, 488 U.S. at 261 (emphasis added), this Court should reject any effort to limit the Commerce Clause's protections depending on the nature of the corporate form. The Commerce Clause is implicated by all impediments to interstate transactions, regardless of the identity of the parties involved in the transaction.

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[3] The United States suggests that "[i]t is an open question whether States are constitutionally *required* to apportion the income of" C Corporations. U.S. Br. 31. But that contention conflicts with decades of this Court's holdings. See pp. 7-12, *supra*.

Nor do practical considerations suggest a different result. The chief concern of the Commerce Clause is to prevent States from interfering with interstate commerce and the economic efficiency that accompanies it. See *H. P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 535 (1949) (explaining historical underpinnings of the Commerce Clause). This "Nation is a common market in which state lines cannot be made barriers to the free flow of both raw materials and finished goods in response to the economic laws of supply and demand." *Hughes* v. *Alexandria Scrap Corp.*, 426 U.S. 794, 803 (1976). Indeed, "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388, 402 (1984) (quotation marks omitted). The fair apportionment requirement was formulated to further that purpose. See, *e.g.*, *Western Live Stock*, 303 U.S. at 256 (explaining that unapportioned taxes on multistate corporations would "renew the barriers to interstate trade which it was the object of the commerce clause to remove").

The Commerce Clause's prohibition on multiple taxation likewise should focus on the effects on interstate commerce itself. Businesses engaged in interstate commerce—whether incorporated, operating as partnerships or proprietorships, for-profit or charitable causes—owe their existence and operations to individuals. And as this Court recently noted, a "corporation is simply a form of organization used by human beings to achieve desired ends." *Burwell* v. *Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2768 (2014). Individuals operating through a particular corporate form (or operating without such organization) should not be subject to disparate and disfavorable double taxation simply because they operate interstate.

C. Maryland's Tax Scheme Fails To Meet the Fair Apportionment Requirement

As Maryland's highest court recognized, Maryland's tax scheme does not survive the tests of internal and external consistency.

1. *Maryland's Tax Scheme Fails the Internal Consistency Test*

A tax is internally consistent "when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." *Jefferson Lines*, 514 U.S. at 185. In other words, a tax is internally consistent if it could be imposed by every State, and "no multiple taxation would result." *Goldberg*, 488 U.S. at 261. But if every State in the country were to apply the same tax scheme and the result would be that interstate commerce suffers a burden that intrastate commerce does not, then the tax scheme is internally inconsistent and invalid under the Commerce Clause. *Jefferson Lines*, 514 U.S. at 185.

The Maryland tax scheme fails the internal consistency test—and blatantly so. A portion of the taxes Maryland imposes applies to the entirety of its residents' income without apportionment and regardless of source, much like the Indiana tax this Court struck down in *J.D. Adams*. 304 U.S. at 307. In particular, Maryland imposes two types of taxes on its residents' income: a "state" tax and a "county" tax.[4] Pet. App. 4-5. Maryland also taxes nonresidents on income earned in Maryland. *Ibid.* If a Maryland resident pays taxes to other States on income earned in those States, Maryland applies (with cer-

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[4] Under Maryland law, both types of taxes are considered state taxes. *Frey* v. *Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011).

tain limitations) a credit against that resident's "state" tax liability. Md. Code Ann., Tax-Gen. §10-703. But Maryland gives no credit against the resident's "county" tax liability. *Ibid.* Thus, a Maryland resident pays a portion of his income tax, levied as a percentage of his entire income, no matter where that income is earned and without regard to whether the income is simultaneously taxed by a different State.

If *every* State (or their municipal subdivisions) were to tax the entirety of resident income regardless of its source, and *every* State (or their municipal subdivisions) taxed the income of nonresidents earned within its borders, taxpayers engaged in interstate commerce would be subjected to multiple taxation. A taxpayer residing in Indiana with income in Ohio, for example, would first pay Ohio taxes on income from Ohio as a nonresident; the taxpayer would then pay Indiana taxes on that same Ohio-based income as an Indiana resident. Conversely, every taxpayer whose income-generating activities occurred entirely within his State of residence would only be subjected to that State's tax. If that same Indiana taxpayer, for example, derived the same income only from sales within Indiana, the income would be taxed only once. As a result, interstate commerce would be burdened in a way that intrastate commerce would not. This "failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction." *Jefferson Lines*, 514 U.S. at 185. That, in turn, demonstrates that the State's tax scheme imposes a burden on interstate commerce that intrastate commerce does not face, and therefore offends the Commerce Clause. *Ibid.*

Both the Comptroller and the United States argue that the constitutionality of a state tax should not be de-

pendent on the taxing decisions of other States. Comptroller Br. 30-32; U.S. Br. 10-12. That statement is correct, but it does not advance their cause. This Court has held that the fair apportionment requirement applies even if no other State has actually imposed the same tax. *Central Greyhound*, 334 U.S. at 663. To fail the fair apportionment requirement, a law need only create the *possibility* that multiple taxation could occur. *Ibid.* The internal consistency test thus considers the hypothetical situation where every State does impose an identical tax. And the Comptroller and the United States cannot dispute that Maryland's tax scheme, if adopted by every State, would subject interstate commerce (but not intrastate commerce) to double taxation. It thus is not the case that Maryland's power to impose its tax would "vanish and reappear according to how other states choose to tax." Comptroller Br. 32. The tax is unconstitutional regardless of whether Maryland is alone or joined by others in "attempting to take more than its fair share of taxes from the interstate transaction." *Jefferson Lines*, 514 U.S. at 185.

2. *Maryland's Tax Scheme Fails the External Consistency Test*

While failure to meet the internal consistency test is itself fatal, Maryland's tax fails the external consistency test as well. A tax is externally consistent if it applies to "only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262. A state tax fails the external consistency test if it "reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines*, 514 U.S. at 185.

In this case, much of the Wynnes' income is generated by their S Corporation, Maxim Healthcare, and "passes through" to them. Under both federal and Maryland tax statutes, that income is attributed to them as if it "were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation." 26 U.S.C § 1366(b); Md. Code Ann., Tax-Gen. § 10-107. Accordingly, the Wynnes' income derives from the States in which Maxim Healthcare does business, including the 39 States to which Maxim Healthcare paid income taxes in 2006. Pet. App. 9. By taxing income earned in other States and providing the Wynnes with no credit against the county tax for taxes paid to other States on that income, Maryland taxes income that is not attributable to economic activity in Maryland.

That is precisely the sort of beggar-thy-neighbor regime the Commerce Clause abhors. The States from which the Wynnes derive income provide enormous benefits to the Wynnes and their businesses, including economic markets conducive to earning that income, local services such as fire and police protection, and infrastructure. As such, those States fairly tax the Wynnes on the income earned in those States. See *Schaffer*, 252 U.S. at 51. Maryland itself recognizes the value States provide to nonresidents, as it taxes nonresidents on income earned in Maryland. Pet. App. 4-5. Such revenue pays for the local services Maryland provides to those nonresidents, and is one way that interstate commerce is made to "pay its way." *Western Live Stock*, 303 U.S. at 254.

Maryland's unapportioned taxation of the Wynnes' out-of-state income cannot be reconciled with that structure. Maryland taxes income that was produced with no assistance or support from Maryland, and places a dis-

proportionate burden of support on the Wynnes. Generating more income from out-of-state sources does not plausibly suggest that they use more local services. If anything, the more income a taxpayer earns out of state, the more likely it is that the taxpayer is using *fewer* services in-state. Nevertheless, in 2006, the Wynnes already funded local services with the more than $81,000 they paid in county taxes on income earned in Maryland. J.A. 19 (line 31). Further, the Wynnes paid over $42,000 in state taxes on income earned in Maryland, a portion of which paid for local services. J.A. 19 (line 30). And they paid thousands more in property taxes. Wynnes' C.A. Br. 46 n.17. By seeking tax revenue derived from income earned in other States, Maryland's tax scheme overreaches, burdening interstate commerce and the Wynnes themselves.

II. The Rule Urged By The Comptroller Would Threaten Grave Harm To The National Economy

The burden imposed by Maryland's tax scheme has particularly troubling implications for the business community. Allowing States to tax the entirety of a resident's income, without accounting for taxes paid to the State where the income was derived, threatens to "renew the barriers to interstate trade which it was the object of the commerce clause to remove." *Western Live Stock*, 303 U.S. at 256. Under this Court's functional approach to the Commerce Clause, those potential effects confirm the infirmity of Maryland's tax scheme. States have no authority to balkanize the Nation's integrated economy by discriminating against goods and services that cross state borders. Nor can they achieve the same result by failing to comply with this Court's well-established requirement that taxes be fairly apportioned.

A. Maryland's Tax Scheme Obstructs Business and Capital in Interstate Commerce

The impact of Maryland's tax scheme is obvious: It encourages Maryland businesses to keep their revenue-generating operations in (or move those operations to) the State to avoid multiple taxation. That is precisely the sort of "pressure on an interstate business to conduct more of its activities" in-state that the Commerce Clause proscribes. *Amerada Hess Corp.* v. *Dir., Div. of Tax.*, 490 U.S. 66, 77-78 (1989).

For example, a Maryland resident with a small business selling high-tech solar panels might find it attractive to expand into nearby Virginia. In the "area of free trade among the several States" the Commerce Clause was designed to create, *Westinghouse Elec. Corp.*, 466 U.S. at 402 (quotation marks omitted), she would base her decision on factors related to revenues and expenses, such as potential customers, potential competitors, and costs associated with providing services in Virginia, including Virginia taxes. If those factors offered better opportunities than comparable expansion within Maryland, she ordinarily would expand into Virginia. But Maryland's tax scheme throws a monkey wrench into that calculation. Under it, the Maryland business owner would determine her expected earnings from Virginia, net of Virginia taxes, and then deduct out *another* unapportioned Maryland county tax on the same revenues. As a result, even if the opportunities were in all other respects equal, the business owner would choose to expand in Maryland rather than Virginia *solely* because expansion into Virginia is burdened not just by Virginia taxes but by Maryland's unapportioned county tax as well.

Indeed, even if the Maryland business market presented a less advantageous opportunity than Virginia's,

Maryland's tax scheme would steer expansion into Maryland whenever the difference in expected profits were less than the marginal Maryland county tax liability. The Maryland business owner would feel precisely the "forbidden impact on interstate commerce" that this Court has condemned in the past, as the Maryland tax scheme "exerts an inexorable hydraulic pressure on interstate businesses to ply their trade within the State that enacted the measure rather than 'among the several States.'" *Scheiner*, 483 U.S. at 286-287 (quoting U.S. Const. art. I, §8, cl. 3).

That burden is particularly acute for industries that operate on already narrow profit margins (often to consumer benefit). For such businesses, Maryland's tax scheme would make almost *any* interstate expansion a significantly less attractive option. The Commerce Clause forbids that result not because it is poor economic policy (though it undoubtedly is). The Commerce Clause forbids it because it imposes a burden on interstate commerce that intrastate commerce does not have to bear.

Maryland's tax scheme denies benefits to out-of-state consumers who would benefit from the expansion of Maryland businesses into their neighborhoods (in our example, Virginia solar-panel buyers). It also denies out-of-state businesses the ability to attract Maryland investors or business partners. Because of Maryland's unapportioned county income tax, an out-of-state business in neighboring Pennsylvania, for example, may have a harder time obtaining capital from Maryland investors. A Maryland investor looking at a Pennsylvania business opportunity may balk if he knows that he will be taxed multiple times on his share of that company's income—first by Pennsylvania, and then again by Maryland. If the Maryland investor puts his money in a Maryland

business instead, he avoids that double taxation. Unless the Pennsylvania company can outperform its Maryland competitor by the amount of the Maryland county tax liability, Maryland investors would just as soon invest in-state. Maryland may find it advantageous to discourage its residents from investing outside the State in favor of in-state opportunities, but that is the sort of preference the *Commerce* Clause will not tolerate. And the pursuit of similar policies by all States would dam the flow of capital across state boundaries to the detriment of all. Neither Maryland nor any other State should be permitted to impose such burdens on interstate commerce—the very barriers the Commerce Clause was designed to remove.

B. The Comptroller's "Residency" Justification Defies Precedent and Reason

The Comptroller seeks to avoid the fair apportionment requirement entirely on the theory that, because the tax is based on "residency," only Maryland's own residents will suffer double taxation. Comptroller Br. 37. Under this Court's cases, however, the taxpayer's residence is irrelevant to whether a particular tax scheme impermissibly subjects an interstate transaction to multiple taxation. See, *e.g.*, *J.D. Adams*, 304 U.S. at 308 (striking down an unapportioned Indiana tax as applied to an Indiana corporation); *Gwin*, 305 U.S. at 435 (striking down an unapportioned Washington tax as applied to a Washington corporation). The argument also makes no sense. Taxes that discriminate against Maryland residents for doing business outside that State burden interstate commerce no less than taxes that discriminate against nonresidents who do business inside that State.

The claim that Maryland's tax scheme need not be fairly apportioned because it is based on the "status" of

"being a resident," Comptroller Br. 37-39, also rests on the sort of label-based formalism this Court's Commerce Clause jurisprudence eschews. In *Complete Auto*, the Court rejected the argument that the name or description attached to an otherwise impermissible tax can somehow save it. 430 U.S. at 288. The Court noted that that type of analysis "merely obscures the question of whether the tax produces a forbidden effect." *Ibid.*; see also *West Lynn Creamery*, 512 U.S. at 201 ("Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce."). Whatever label is attached to it, Maryland's tax scheme has the *effect* of exposing the Wynnes' income to the threat of impermissible multiple taxation. It is that effect that renders the tax repugnant to the Commerce Clause.

In any event, it is something of a misnomer to label the tax at issue as "based on residency." Comptroller Br. 37. The tax is imposed on and measured by income—not on some measure of the individual's residency. If every State could tax all of its residents' income from any source on the theory that the tax is based on residency, the Commerce Clause would cease to offer any protection so long as the State chooses appropriate labels. It is clear that Maryland could not, for example, impose a use tax on out-of-state purchases made by its residents, based upon their status as residents, and refuse to provide a credit even when those residents paid a sales tax on that transaction in another State. Such a tax would result in the multiple taxation of an interstate transaction prohibited by the Commerce Clause. *Jefferson Lines*, 514 U.S. at 194-195. The Comptroller's rationale, however, would support precisely that result. No matter how the Maryland tax scheme is described, it subjects out-of-

state transactions and the resulting income to the risk of multiple taxation. Because that offends the Commerce Clause, the judgment of the Maryland Court of Appeals should be affirmed.

C. State Penalties on Domestic Businesses for Out-of-State Operations Are of No Less Concern Than State Efforts To Exclude Out-of-State Businesses from In-State Operation

The Maryland tax scheme impermissibly pressures in-state businesses to remain in-state. That type of interference with interstate commerce is just as troubling as State efforts to exclude out-of-state businesses from their boundaries. Indeed, it raises the same concerns that prompted the adoption of the Commerce Clause to begin with: "tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Jefferson Lines*, 514 U.S. at 180 (quoting *Wardair Canada, Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1, 7 (1986)).

Maryland's tax scheme imposes a penalty in the form of multiple taxation of *any* income earned in another State that (like Maryland) taxes income derived within its borders. As such, the scheme has the "inevitable effect" of "placing a financial barrier around" Maryland. *Scheiner*, 483 U.S. at 284. If Maryland wishes to promote expansion of local businesses, it has many means at its disposal, including the provision of subsidies. See, *e.g.*, Md. Code Ann., Econ.-Dev. §5-540 (authorizing financial assistance to small businesses). But penalizing businesses that venture out of state and restricting the free flow of capital beyond Maryland's borders is not among them.

CONCLUSION

For the foregoing reasons, and those stated in respondents' brief, the judgment of the Court of Appeals of Maryland should be affirmed.

Respectfully submitted.

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SEPTEMBER 2014

AMICUS CURIAE BRIEF

No. 13-485

IN THE

Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

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INTEREST OF *AMICUS CURIAE* [1]

Council On State Taxation ("COST") is a non-profit trade association formed in 1969 to promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST represents nearly 600 multistate businesses in the United States, including companies in numerous industries. As *amicus*, COST has participated in many of the significant tax cases to come before this Court in recent years, including: *Direct Marketing Association v. Brohl*, 735 F.3d 904 (2013), *petition for cert. granted*, No. 13-1032 (Jul. 1, 2014); *Levin v. Commerce Energy*, 560 U.S. 413 (2010); *CSX Transportation, Inc. v. Alabama Dep't of Rev.*, 131 S.Ct. 1101 (2010); *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1 (2009); and *MeadWestvacoCorp. v. Illinois Department of Rev.*, 553 U.S. 16 (2008). COST has also advocated for federal legislation, the Mobile Workforce State Income Tax Simplification Act of 2013 (S. 1645/H.R. 1129), to mitigate the issues facing both employees and their employers when employees earn income in multiple states.

COST's membership has a vital interest in ensuring states do not impede the rights of all businesses to engage in commerce in the national market. To that end, it is important to COST members that states provide fair apportionment or credits for taxes paid to their resident businesses for income earned and taxed

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae* has made a monetary contribution to the preparation or submission of this brief. The parties received timely notice of *amicus's* intent to file this brief. Written consent of all parties to the filing of this brief has been filed with the Clerk of this Court.

in other states. Maryland's denial of credits for the county portion of its income tax on resident taxpayers who paid taxes on the same income in other states creates a regime of double taxation and impedes businesses from participating in the national market. The Commerce Clause prohibits multiple or discriminatory taxation of interstate commerce. *Amicus* believes resident taxpayers should not suffer double taxation on income earned out of state.

STATEMENT OF THE CASE

This case concerns a decision by the Maryland Court of Appeals holding the State's income tax law discriminates against interstate commerce in violation of the Commerce Clause of the U.S. Constitution.[2] *Maryland State Comptroller of Treasury v. Wynne*, 64 A.3d 453 (2013).

Respondents Brian and Karen Wynne (the Wynnes) are Maryland residents that filed a joint income tax return in Maryland for the year at issue. Pet. for Cert. 3. Mr. Wynne is a shareholder of an S corporation, Maxim Health Services Inc. (Maxim). In the year at issue, the Wynnes earned income from two sources: their salaries and Mr. Wynne's flow-through share of Maxim's income based on his 2.4 percent ownership of the company. Pet. for Cert. App. 56, 86. As residents, the Wynnes paid Maryland income tax in full on their salary income (without credits). They did not pay an income tax on it to any other state.

Maryland follows federal law and treats this income from Maxim (and other pass-through entities) as though the owners "realized [the income] directly from the source from which [it was] realized by the

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[2] U.S. CONST. art. I, § 8, cl. 3.

corporation, or incurred in the same manner as incurred by the corporation." 26 U.S.C. § 1366(b), MD. CODE ANN., TAX-GEN. § 10-107. When filing their joint return in Maryland, the Wynnes claimed credits for taxes paid in 38 other states on income earned by Maxim in those states. Pet'r Br. 5 (hereafter "Comptroller's Br."); Resp't's Br. in Opp. 7 (hereafter "Wynne Br."). Nonresident owners of a pass-through entity doing business in Maryland are taxed on their pass-through income sourced to Maryland based on the entity's (Maxim's) apportionment formula.[3] However, for residents, Maryland taxes 100 percent of their share of a pass-through entity's income on a non-apportioned basis. Maryland provides a partial income tax credit to resident taxpayers who pay income tax to another state. MD. CODE ANN., TAX-GEN. § 10-703.

When claiming a credit for taxes paid in other states, the Wynnes were only allowed to claim a credit against Maryland's state tax rate of 4.75%, but not the 3.2% county portion of the tax. The Comptroller asserts Maryland has no duty to provide a tax credit to its residents, but rather Maryland's law provides the state-level credit merely as a matter of legislative grace. Comptroller's Br. 23-24. The result is that income earned out of state is potentially taxed 40% higher than income earned in Maryland.

The Wynnes challenge the constitutionality of the Comptroller's practice of assessing state income tax without providing a credit for taxes paid in other

---

[3] Nonresident owners of a pass-through entity doing business in Maryland are subject to tax based on a three-factor apportionment formula including property, payroll, and double-weighted sales. MD. CODE REGS. § 03.04.03.08.

states. The Wynnes argue this double taxation violates the Commerce Clause by discriminating against interstate commerce. The Maryland Tax Court ruled in favor of the Comptroller. Pet. for Cert. App. 140-41. The Circuit Court reversed. The Maryland Court of Appeals upheld that reversal, finding Maryland's failure to provide the Wynnes with full credit against income previously taxed in another state "violates the dormant Commerce Clause and the federal Constitution." *Id.* at 32.

SUMMARY OF THE ARGUMENT

This case provides this Court with an opportunity to reinforce the Commerce Clause's prohibition on purposeful multiple taxation of income earned in more than one state. Under the Due Process Clause, a state may impose an income tax on 100 percent of its resident's income. However, this authority must withstand Commerce Clause scrutiny—intrastate commerce cannot be favored to the detriment of interstate commerce under the test set forth in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

For purposes of a state corporate income tax, states commonly adopt formulary apportionment to avoid double taxation of income earned in more than one state. In contrast, states that impose an individual income tax uniformly offer a credit for taxes paid to other states to avoid double taxation of income earned in more than one state. However, Maryland allows only a partial credit for taxes paid to other states—which in this case only provided a credit for approximately three-fifths of the taxes paid to other states. This outcome violates the Commerce Clause by imposing a greater tax on income derived from interstate commerce than from intrastate income. The

Maryland partial tax credit system utterly fails the second and third prongs of the *Complete Auto* test.

The Commerce Clause protection against multiple taxation is not dependent on: 1) the taxpayer's choice of business entity, or 2) the type of income tax a state chooses to employ. To hold otherwise in this case means there are two Commerce Clauses—one for entities subject to a state's corporate income tax and another for entities subject to a state's individual income tax. In the case of the former, the Commerce Clause would prohibit discrimination against interstate commerce, but in the case of the latter, the Commerce Clause would offer no such prohibition.

Given the rapid growth of business taxation under the individual income tax over the last three decades, this disparity in treatment would leave over 90 percent of all business entities (*e.g.*, S corporations, partnerships and sole proprietorships)—which account for over 40 percent of all income taxes on business income[4]—outside the protection of the Commerce Clause's prohibition against double taxation.

This result would unravel one of the primary reasons why the Commerce Clause was included in the U.S. Constitution—to prevent states from favoring local commerce over interstate commerce.

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[4] Annette Nellen, *Data on Different Types of Business Entities*, http://www.cob.sjsu.edu/facstaff/nellen_a/Data_Different_Types_Business_Entities.pdf (Based on IRS, Integrated Business Data).

ARGUMENT

I. THE DORMANT COMMERCE CLAUSE'S PROHIBITION AGAINST DISCRIMINATORY TAXATION OF INTERSTATE COMMERCE APPLIES TO THE STATES' INDIVIDUAL INCOME TAXES

In invoking the formalism of the line of cases from *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1951), the Comptroller repeatedly claims that the "Maryland tax scheme is based on the status of residency, not on any particular income earning activity in Maryland." Comptroller's Br. at 9 and 16, citing *Freeman v. Hewit*, 329 U.S. 249, 255 (1946). Maryland's controversial individual income tax system is not a tax on an individual's "status" as a resident of the State. Both Maryland residents and nonresidents earning income sourced to Maryland are subject to Maryland's individual income tax. Simply put, the "income tax" is measured by income. As this Court observed, "[a] tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358, 374 (1991) (internal citation omitted).

"Residence" is a meaningless concept for the Commerce Clause. The Comptroller and his *amici* maintain there should be a difference between the state taxation of individuals and corporations based on overruled and archaic authorities. However, this view is inconsistent with this Court's repeated renunciation of the formalism espoused by those cases.

A. The Due Process Clause Does Not Restrain States from Taxing Their Residents

Under *International Shoe Co. v. Wash.*, 326 U.S. 310 (1945), the test for Due Process Clause purposes is "minimum contacts," not "residence." This means a party may be subject to a state's jurisdiction if it has minimum contacts with that state. Focusing on the "minimum contacts" test, there is no doubt Maryland possesses sufficient Due Process Clause nexus with the Wynnes.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), this Court clarified the Due Process Clause and Commerce Clause are "two constitutional requirements [that] differ fundamentally, in several ways." *Id.* at 305. "[W]hile Congress has plenary power to regulate commerce among the States . . ., *see International Shoe Co. v. Washington*, 326 U.S. 310 (1945), it does not similarly have the power to authorize violations of the Due Process Clause." *Id.* Additionally, "[t]here may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce." *Id.* at 305-06, citing *International Harvester Co. v. Department of Treasury*, 322 U.S. 340 (1944).

In *Quill*, this Court had no problem finding Quill had sufficient contacts with North Dakota for Due Process Clause purposes, but held the State's authority to impose a collection and remittance responsibility on Quill for its sales/use tax was *not* constitutionally sustainable under the Commerce Clause. *Quill* at 318. The Comptroller and his *amici*

cite *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450 (1995), for the proposition a state can tax its residents on all of their income. However, that case does nothing other than support the notion that Maryland's income tax on its residents is sustainable under the Due Process Clause. That case addressed members of an Indian tribe living outside of tribal lands and conducting their tribal business within the territorial confines of Oklahoma who alleged they were immune to Oklahoma's individual income tax by virtue of tribal tax immunity. The Court specifically held "that Oklahoma may tax the income (including wages from tribal employment) of all persons, Indian and non-Indian alike, residing in the State outside Indian country." *Id.* at 453. *Chickasaw Nation*, however, was devoid of any Commerce Clause analysis and says nothing about whether the Commerce Clause protects the act of generating income across state lines.[5]

While modern Due Process Clause jurisprudence answers the question of whether Maryland *may* tax its residents, it says nothing about *how much* Maryland may tax its residents. To answer the question of "how much?" this Court in *MeadWestvaco Corp. v. Ill. Dep't*

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[5] Two other cases cited by the Comptroller, *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937) and *Lawrence v. State Tax Comm'n*, 286 U.S. 276 (1932), also do nothing but sustain a tax under the Due Process Clause and *not* the Commerce Clause. In *Cohn*, a New York resident was denied a refund of New York income taxes on rental income derived from New Jersey. The parties stipulated that New Jersey did not tax that income—a situation very different from the case at hand. *Cohn* at 311. This Court in *Lawrence* specifically held a state's unrestricted power to tax *cannot* be "palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment." *Lawrence* at 280.

of Rev., 553 U.S. 16 (2008), properly looked to the Commerce Clause.

> The Commerce Clause and the Due Process Clause impose distinct but parallel limitations on a State's power to tax out-of-state activities . . . Where, as here, there is no dispute that the taxpayer has done some business in the taxing State, *the inquiry shifts from whether the State may tax to what it may tax.*

Id. at 24-25 (italics added).[6]

Finding no infirmity with the Due Process Clause, the next step is to review the restrictions imposed by the Commerce Clause.

B. The Commerce Clause Is Applicable to *All* State Taxes Affecting Interstate Commerce

The Commerce Clause does not distinguish between state taxes, whether levied upon individuals or corporate entities:

> *Complete Auto* emphasized the importance of looking past 'the formal language of the tax statute [to] its practical effect,' and set forth a four-part test that continues to govern the

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[6] *See also Nippert v. Richmond*, 327 U.S. 416, 423-424 (1946): "But beyond the presence of a sufficient connection in a due process or 'jurisdictional' sense, whether or not a 'local incident' related to or affecting commerce may be made the subject of state taxation *depends upon other considerations of constitutional policy having reference to the substantial effects, actual or potential, of the particular tax in suppressing or burdening unduly the commerce*" (italics added).

> validity of state taxes under the Commerce Clause.

Quill Corp. at 310.

When this Court said *Complete Auto* governs the "validity of state taxes," it did not mean *Complete Auto* applies to all state taxes *except* taxes levied upon individuals. It should come as no surprise that Commerce Clause protection has been applied to a wide variety of state taxes, including taxes that individuals must pay. *See e.g.*, *Camps Newfound/ Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (local property taxes); *Quill Corp.*, 504 U.S. 298 (1992) (sales taxes); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (intangibles tax); and *Tyler Pipe Indus. v. Dep't of Rev.*, 483 U.S. 232 (1987) (gross receipts tax).

Fulton effectively rebuts the Comptroller's contention that taxes paid by a state's residents are somehow immune to a Commerce Clause challenge. *Fulton* involved a successful Commerce Clause challenge to a North Carolina intangibles tax imposed upon *residents* of North Carolina. *Fulton* at 327. The Comptroller's reliance upon a line of *Spector*-era cases is fatal to his novel proposition that the Commerce Clause applies to all manner of state taxes except individual income taxes. This Court has made it clear: "*Spector* is an anachronism." *Complete Auto* at 287.

The Comptroller's and his *amici*'s repeated refrain from *Goldberg* that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes" grossly misses the mark. *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989); Comptroller's Br. at 42; Br. for the United States as *Amicus Curiae* Supp. Pet'r 5-6, 18; Br. Multistate Tax Commission as *Amicus Curiae* Supp. Pet'r 8. The Wynnes' complaint

relates to Maryland imposing its tax on income earned outside the State at an effectively higher rate than income earned in Maryland. Clearly, the purpose of the Commerce Clause is to protect economic activity subject to taxation in multiple states. As Professor Hellerstein observed, this Court has since repudiated its remark:

> [I]n an unfortunate dictum, the Court declared that '[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes.' In fact, the Court could not have meant what it said. If a state imposes a tax on state residents' purchases of out-of-state but not in-state goods, the tax would be struck down in short order. A more blatant discrimination against interstate commerce in violation of the 'free trade' principles underlying the Commerce Clause is difficult to imagine. *It is a cardinal purpose of the Commerce Clause to protect state residents from their own state taxes when those taxes discriminate against interstate commerce.* Fortunately, in 1994 the Court repudiated its ill-considered dictum (at least implicitly) by observing that '[s]tate taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products, they are unconstitutional.

HELLERSTEIN, STATE TAXATION ¶ 4.14 (WG&L 2014), citing *Goldberg* at 266 and *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 203 (1994) (italics added).

It is clear the Commerce Clause protects interstate commerce, whether engaged in by residents or non-

residents, corporations or individuals. After all, this Court struck down a tax that operated against local interests when that tax discriminated against interstate commerce. *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977); *see also Fulton*.

As this Court stated in *Complete Auto*,

> There is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect. Simply put, the Spector rule does not address the problems with which the Commerce Clause is concerned.

Complete Auto at 288.

This is exactly the question at bar. Does the formalism of "residency" obscure the question of whether the Maryland tax produces a forbidden effect? In striking down *Spector*, the Court made plain in *Complete Auto* that talismans of "privilege" no longer animate the Commerce Clause. Instead of focusing on *substance*, the Comptroller and his *amici* make strenuous arguments for respect of *form*. However, form does not hide the fact that Maryland's income tax discriminates against interstate commerce. The Comptroller's adherence to form is fatal to his case. Like the Equal Protection Clause cases of *Darnell v. Indiana*, 226 U.S. 390 (1912), and *Kidd v. Alabama*, 188 U.S. 730 (1903), the cases cited by Comptroller and *amici* have "been bypassed by later Commerce Clause decisions." *Fulton* at 326 (internal citations omitted).

The Comptroller maintains there should be a difference between the state taxation of individuals and corporations based on overruled and archaic authorities. However, this position is inconsistent with this Court's message in *Jefferson Lines*, where this Court noted that its modern four-part test in *Complete Auto* has broadly been used in the following cases:

> *Goldberg v. Sweet*, 488 U.S. 252 (1989) (tax on telephone calls); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988) (use tax); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983) (franchise tax); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (severance tax). We apply its criteria to the tax before us today [(sales tax)].

Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 183 (1995).

All this is not to say residency (or the domiciliary state) does not have any importance; however, it does not remove a tax from the Commerce Clause's protection. For example, the domiciliary state may impose a tax on the value of property if that property has not obtained a taxable situs in any other state. *See Standard Oil Co. v. Peck*, 342 U.S. 382, 384 (1952). In contrast, if the property is subject to taxation in two or more states, that precludes the domicile state from taxing 100% of the property. *Id.* Thus, *amicus* is not asserting Maryland cannot tax 100% of its residents' income, but if such income is subject to tax in two or more states, the State's tax structure must prevent duplicative taxation. For income tax purposes, a state may accomplish this by: (1) apportioning multi-jurisdictional income of a business or, alternatively, (2) by providing a credit for the income taxed by

another state(s). "Otherwise there would be multiple taxation of interstate operations." *Id.* at 385.[7]

The provision of a credit for taxes paid to other states satisfies Commerce Clause requirements against double taxation, not just for income taxes, but for sales and use taxes as well. When this Court reviewed Louisiana's use tax, it noted the state reduced the risk of multiple taxation by providing a credit. *D.H. Holmes* at 31. The same has been said when this Court reviewed an Illinois telecommunication excise tax: "To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation." *Goldberg* at 264.

In many ways the method Maryland and other states employ to tax individuals' income is similar to the states' sales and use tax systems. With sales tax, the state where the sale took place is the first to be entitled to impose a sales or use tax on the transaction. The states, when imposing their income tax on nonresidents, do not look to a sale, but instead impose tax on the individual's income earned in that state (the "source" state of income). A subsequent state—be it the state of subsequent "use" for purposes of the sales and use tax or the resident state for purposes of the income tax—may only impose its "use" or "income" tax

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[7] Residency (or the domiciliary state) is also important for determining which state can tax income that does not have a business purpose. This Court refused to extend the apportionment of all income earned by a business in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992). As with corporate income taxes, the same holds true here with Maryland's income tax; its residents' income from nonbusiness sources would be subject to the State's income tax.

on the differential rate. *See Jefferson Lines* at 194 citing *KSS Transportation Corp. v. Baldwin*, 9 N.J. Tax 273, 285 (1987). The risk of multiple taxation is eliminated because a taxpayer knows any subsequent state will have to provide a credit for the taxes paid to prior states. *Jefferson Lines* at 194. Maryland's individual income tax with its partial credit mechanism fails to satisfy the requirement for a full credit for income taxes paid to other states on the same income.

The Comptroller's and his *amici*'s contentions that the Commerce Clause is not applicable to this case must fail. The decision of the Maryland Court of Appeals must stand.

C. Voting Rights Do Not Mitigate a State's Constitutional Limitations to Tax Residents

Instead of viewing double taxation as a constitutional infirmity, the Comptroller advises the Wynnes to seek a political fix. Comptroller's Br. at 24. However, since the State created the problem with its tax laws, the burden of fixing the problem should rest with the State, not with the taxpayer.

Claiming this is only a political issue for Maryland's voters to decide is contrary to this Court's decision in *Associated Indus. v. Lohman*, 511 U.S. 641 (1994). Applying the Commerce Clause, this Court rightly held Missouri's imposition of a use tax exceeding the local sales tax was discriminatory. If residents in Missouri elect legislators that tell the residents and its businesses in Missouri to pay more tax on purchases from sellers located outside of Missouri, what is wrong with that? Clearly, as this Court noted, it provides an unconstitutional advantage to in-state sellers.

Maryland's income tax scheme is no different; it provides preferential treatment for income earned and subject to tax solely within the state to income earned and subject to tax outside of the state. To treat this as a political question contravenes the inclusion of the Commerce Clause in the U.S. Constitution. Voters, and the representatives they place in office, do not have the right to enact laws contrary to the U.S. Constitution. To hold otherwise would allow states to favor in-state economic activity and local interests over foreign economic activity or interests. *Cf. Camps Newfound/Owatonna, Inc.* (how would Maine's property tax exemption favoring camps that served mostly the state's residents be found unconstitutional?).[8]

The Comptroller's position is rooted in the principle that individuals are in a class of their own based on their ability to vote, and with that power, they do not need protections afforded by the Commerce Clause. Because of this, the Comptroller contends that while corporations may enjoy all of the constitutional protections of credits and apportionment, individuals do not. This Court recently addressed questions of whether corporations are entitled to fewer rights than individuals. *See Burwell v. Hobby Lobby Stores, Inc.*,

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[8] *Amicus* acknowledges that a state can tax its residents' purely instate activity greater than their interstate activity. *See Allied Stores v. Bowers*, 358 U.S. 522 (1959) (sustaining a property tax exemption for goods only stored in the state for export by a nonresident under an Equal Protection Clause challenge). Because intrastate commerce was burdened with a greater tax than interstate commerce, there was no Commerce Clause issue. Maryland's taxing scheme violates the dormant Commerce Clause because it does just the opposite, it taxes income earned solely within the state at a lower rate than the same income if earned in interstate commerce.

134 S. Ct. 2751 (2014); *Citizens United v. FEC*, 558 U.S. 310 (2010). It is ironic the Comptroller and his *amici* now urge this Court to answer the question: Do individuals have fewer constitutional rights than corporations?

Neither the Wynnes, nor *amicus*, are asserting that residents are entitled to a tax credit for *all* taxes paid to another state. Clearly, if the resident state does not tax the income taxed by another state, the resident state may, but is not required, to provide a credit in that circumstance. (For example, if a nonresident state taxes lottery winnings not subject to tax in an individual's resident state, the resident state is not required to provide a tax credit for taxes paid on those lottery winnings against other income earned by the resident in that state.) In addition, the credit can be limited to not exceed the tax rate imposed by the resident state. States retain their sovereignty to tax within constitutional limits. When a state like Maryland imposes an income tax on both residents and nonresidents, it must provide a credit to avoid multiple taxation of the same income.[9]

Nothing about this case will prevent states from imposing different types of taxes on business activity

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[9] The same holds true with a state using a different tax scheme for taxing the income of pass-through entities from that at the federal level. If a state imposes the tax only on a pass-through entity (*e.g.*, limited liability company, general or limited partnership, S Corporations, etc.), similar to how many states tax C Corporations, an individual may be prevented by the state from claiming a tax credit on the tax *owed* by the pass-through entity. However, that is not the situation in this case. Maryland, like the vast majority of other states, has elected to tax the owners of pass-through entities—deciding not to impose an income tax directly on the entities themselves.

in a state. States are free to continue to tax C Corporations using an apportionment formula and individuals (residents and nonresidents) on all their income. Alternatively, as done in Ohio, Texas and Washington, they can subject businesses to a gross receipts tax that may or may not have some deductions.[10] States may also impose separate taxes on communication services, public utility services, and insurance. There is no erosion of a State's sovereignty; the Wynnes and *amicus* only assert all these taxes continue to be subject to the scrutiny of the Commerce Clause.

Voting is a right given to state residents, but such right does not serve to invalidate those residents' Commerce Clause protections against discriminatory taxation.

D. Maryland's Partial Tax Credit Mechanism Violates the Dormant Commerce Clause Under the *Complete Auto* Test

Having established the Commerce Clause applies and cannot be bypassed by voting, *amicus* will now show how Maryland's tax credit system fails to meet the test set forth in *Complete Auto*. In *Complete Auto*, this Court held a state tax does not run afoul of the dormant Commerce Clause if the tax: 1) applies to an activity with a substantial nexus with the taxing state; 2) is fairly apportioned; 3) is not discriminatory towards interstate or foreign commerce; and 4) is fairly related to the services provided by the State. *Complete Auto* at 279. The Court of Appeals

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[10] Ohio Rev. Code Ann. § 5751.03; Tex. Tax Code Ann. § 151.054; Wash. Rev. Code Ann. § 82.04.240.

correctly held Maryland's partial tax credit mechanism violates the second and third prongs of the test. Pet. for Cert. App. 17-32.

(i) The Partial Tax Credit Mechanism Is Not Fairly Apportioned, Failing the Second Prong of the *Complete Auto* Test

The second prong of the *Complete Auto* test requires a state tax to be fairly apportioned. *Complete Auto* at 279. "It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause. In order to prevent multiple taxation of interstate commerce, the Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 424, 446-47 (1979).

To determine whether a state tax is fairly apportioned, it must be both internally consistent and externally consistent. *Goldberg* at 261. Internal consistency requires a tax to be structured in a way that if every state imposed an identical tax, no multiple taxation would result. *Id.* If every state provided a Maryland-type partial credit against its income tax, taxpayers earning income from sources outside their resident state would be taxed at higher rates than those taxpayers only earning income within the state.[11]

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[11] The Court of Appeals provided a good example of how Maryland's credit system is internally inconsistent. *See* Pet. for Cert. App. 20-22.

The Comptroller asserts he can tax a resident on all of the resident's income regardless of the source of income or the fact that the income is subject to tax in other states. The Comptroller advocates this outcome at the same time he acknowledges that Maryland taxes nonresidents on their income from sources within Maryland. Pet. for Cert. App. 20-23.

There is no question that Maryland's taxing scheme violates the internal consistency test. Here, Maryland clearly imposes a 100 percent tax on its residents—without giving a full credit for taxes paid to other states on the same income. And Maryland also taxes nonresidents on their income earned in Maryland. If every state had the same law, the resident with income subject to tax in another state would be subject to multiple taxation.

This Court has held numerous times that states can satisfy internal consistency and prevent multiple taxation on unapportioned tax by providing credits. *See, e.g., Goldberg* at 264 ("To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation."); *Jefferson Lines* at 193 ("True, it is not Oklahoma that has offered to provide a credit for related taxes paid elsewhere, but in taxing sales Oklahoma may rely upon use-taxing States to do so. This is merely a practical consequence of the structure of use taxes . . . use of goods is taxed only to the extent that their prior sale has escaped taxation.") *See also Maryland v. Louisiana*, 451 U.S. 725 (1981) (finding Louisiana's use tax discriminated against interstate commerce in favor of local interests).

Nevertheless, the Comptroller maintains that Maryland's system of not providing full credits should

stand. If Maryland does not fully credit income taxes paid in other states, then why should it, or any other state, be required to credit sales taxes paid to other states against its use tax? *Cf. Associated Indus. v. Lohman*, 511 U.S. 641 (1994). For that matter, why should a corporate entity be entitled to apportion its multistate income? According to the Comptroller, so long as the subject of the tax is a "resident" of—or "domiciled" in—Maryland, nothing else matters.

External consistency requires a state to only tax the "portion of revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg* at 262, citing *Container Corp.* at 169-70. As the Court of Appeals correctly noted, the county portion of the tax is externally inconsistent "[b]ecause no credit is given with respect to the county tax for income earned out-of-state . . . when income sourced to out-of-state activities is subject to the county tax, there is a potential for multiple taxation of the same income." Pet. for Cert. App. 26.

Clearly, the Comptroller's contention that the tax is fairly apportioned fails the internal and external consistency tests.

(ii) The Maryland Tax Credit Mechanism Discriminates Against Interstate Commerce, Failing the Third Prong of the *Complete Auto* Test

Maryland's income is not only deficient under the second prong, it also violates the third prong of *Complete Auto*. A state tax cannot discriminate against interstate or foreign commerce. *Complete Auto* at 279. "Even if a tax is fairly apportioned, it may

discriminate against interstate commerce [and] violate the Commerce Clause if it is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce." *Amerada Hess Corp. v. Director, Div. of Taxation*, 490 U.S. 66, 75 (1989). Without Commerce Clause protection, the Maryland partial credit favors Maryland residents that only generate income in the State over those that generate income in other states. The Commerce Clause protects against this type of discriminatory state taxation. *See Fulton; Camps Newfound/ Owatonna*.

In *Fulton*, this Court struck down North Carolina's intangibles tax as facially discriminatory because it discouraged "domestic corporations from plying their trades in interstate commerce." *Fulton* at 333. The similarities between *Fulton* and this case are striking. Applying the county portion of the tax to out-of-state income without applying a credit for out-of-state taxes paid on the same income causes this income to be taxed at a higher rate than income earned through in-state activities. Based on the denial of a credit for the county portion (3.2% out of the 7.95% tax) a taxpayer with out of state income can pay as much as 40% more than a taxpayer with only intrastate income. As such, by failing to provide a credit against the county portion of the state tax the Wynnes paid to other states, the Maryland tax scheme is facially discriminatory.

In *Camps Newfound/Owatonna*, this Court found a state property tax violates the Commerce Clause if its exemption for property owned by charitable institutions excludes those institutions which primarily serve nonresidents. *Id.* at 565. That case involved a state tax exemption for charitable institutions that principally served residents more than nonresidents.

In finding the tax statute facially discriminatory, this Court stated the statute "expressly distinguishes between entities that serve a principally interstate clientele and those that primarily serve an intrastate market . . . such laws are virtually *per se* invalid." *Id.* at 565 (italics in original). "By encouraging isolationism, prohibitions on out-of-state access to in-state resources serve the very evil that the dormant Commerce Clause was designed to prevent." *Id.* at 578.

The same economic isolationism is implicated in this case. By failing to provide a full credit to residents for income earned and taxed out of state, Maryland is taxing income earned in interstate commerce more heavily than income earned in intrastate commerce.

Such in-state favoritism stifles interstate commerce and cannot be upheld under the U.S. Constitution.

II. A CREDIT MECHANISM IS CONSISTENT WITH THE FRAMEWORK USED BY THE STATES WHEN TAXING RESIDENTS WITH INCOME IN MORE THAN ONE STATE

Amicus believes the credit mechanism is consistent with the current individual income tax framework used by the states when taxing multijurisdictional income. The credit mechanism is one of several options permitted under the Commerce Clause to avoid the risk of multiple taxation of business income in interstate commerce. Having failed to find support within this Court's precedent for carving out income earned by a business but taxed under the individual income tax from Commerce Clause protections against multiple taxation of interstate commerce, the Comptroller and his *amici* posit a number of disparate

arguments for why a credit system is not required or does not work. These include arguments by the Comptroller and his *amici* that the credit system: 1) interferes with the sovereignty of a state over its tax system, 2) is too complex to be workable, and 3) unduly deprives the state of revenues needed to fund public service.

Amicus disagrees with the Comptroller on each of these assertions and find them to be diversionary efforts to obfuscate the real issues here. There is nothing in over 200 years of Commerce Clause jurisprudence suggesting that it only applies to a narrow spectrum of business activity that states have chosen to tax under their corporate income tax systems. Rather, it is clear the Commerce Clause protects interstate commerce in all its forms, however it is taxed.

A. The Comptroller's Sovereignty Argument Is Misplaced

The Comptroller and his *amici* spend much time fretting that Maryland's taxing power, indeed its very sovereignty, would be beholden to the whims of other states should the Maryland Court of Appeals decision stand. Comptroller's Br. 2, 13, 27, 32; Br. Int'l Municipal Lawyers Ass'n as *Amici Curiae* Supp. of Pet'r 6, 12, 18. They complain about the encroachment on state sovereignty for individual income taxes—stating those taxes need not be held to the same Commerce Clause standard as other income taxes imposed on corporations. As the Comptroller states in his brief, "By requiring Maryland to grant a full credit for income taxes paid to other states . . . the lower court's ruling wrongly demands that Maryland yield in the exercise of its taxing power to other sovereigns . . . ." Comptroller's Br. 17.

Similarly, the United States bemoans the impact of other states' actions on Maryland:

> It would make little sense for a State's power to collect an income tax from its own residents, in order to fund the services and protection those residents receive, to be circumscribed by the independent actions of another State with a less significant connection to those persons.

Br. for the United States as *Amicus Curiae* Supp. Pet'r 11.

The Comptroller's stance on state sovereignty might be more principled if Maryland chose to tax 100 percent of its residents income and none of the income of nonresidents. However, the Comptroller wants to have it both ways. He wants the freedom to tax all of the income of Maryland's own taxpayers under the "residency" principle, *and* also the authority to tax nonresidents (including nonresident shareholders of Maxim) under the "source" principle. Instead of occupying high ground, the Comptroller's position is hypocritical.

Apportionment and credits are modest limitations placed on state sovereignty to avoid "multiple" taxation. As discussed above, a state can tax its residents on 100 percent of their income, but when another state taxes some of the same income that was earned and appropriately sourced to that second state, then the "residence" principle must give way to the "source" principle (through a credit mechanism) to avoid a constitutional impairment. This has nothing to do with turning the controls of one state's tax system over to another state, but simply reflects accommodations

that need to be made to nurture a national market where business entities operate in multiple states.

Another variation of the "sovereignty" argument floated by the Comptroller and his *amici* is the assertion that a mandatory credit system would be overly complex and unworkable. As the Multistate Tax Commission ("MTC") states in its *amicus* brief,

> The Maryland Court of Appeal's holding that residency-based income taxes must yield to source-based taxes would have far-reaching effects on state and local governments if affirmed by this Court . . . [It] would involve the state courts in a never-ending task of determining whether particular taxes imposed on an individual as a resident should be reduced or eliminated because another state or local government also has jurisdiction to impose a tax on the individual as a nonresident.

Br. Multistate Tax Commission as *Amicus Curiae* Supp. Pet'r 3.

Similarly, the Comptroller weighs in on the intractability of a mandatory credit system:

> Equally important, the acknowledgement that sovereigns may independently exercise their valid taxing powers resolves—or, more precisely, eliminates—the otherwise intractable problem of deciding which of two legitimate states taxes should take precedence over the other. Nothing in the Due Process Clause or the Commerce Clause provides tools for answering that question.

Comptroller's Br. 30

Given these dire descriptions of a credit system, one would think such a mechanism would be alien to state and local taxes. However, quite the opposite is true—every state with a broad-based individual income tax provides a credit for taxes paid to other states.[12] Similarly, every state with a sales and use tax has a credit mechanism for similar taxes paid to other states.[13]

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[12] **Individual Income Tax**: Ala. Code § 40-18-21; Ariz. Rev. Stat. Ann § 43-1071; Ark. Code Ann. § 26-51-504; Cal. Rev. & Tax Code § 180001; Col. Rev. Stat. § 39-22-108; Conn. Gen. Stat. Ann. § 12-704; Del. Code Ann. tit. 30 § 1111(a); D.C. Code § 47-1806.04; Ga. Code Ann. § 48-7-28; Haw. Rev. Stat. § 235-55; Idaho Code Ann. § 63-3029; Ill. Admin. Code tit. 86, § 100.21[illegible]; Ind. Code Ann. § 6-3-3-3; Iowa Admin. Code r. 701-42.6-422; Kan. Stat. Ann. § 79-32, 111; Ky. Rev. Stat. Ann. § 141.070; La. Rev. Stat Ann. § 47:33; Me. Rev. Stat. Ann. tit. 36 § 5217-A; Md. Code Ann., Tax-Gen. § 10-703; Mass. Gen. L. ch. 62, § 6(a); Mich. Comp. Laws § 206.255; Minn. Stat. § 290.06(22); Miss. Code R. 35.III-1.12.100; Mo. Rev. Stat. § 143.081; Mont. Code Ann. § 15-30-2302(1); Neb. Rev. Stat. § 77-2730(1); N.J. Rev. Stat. § 54A:4-1; N.M. Stat. Ann. § 7-2-13; N.Y. Tax Law § 620(a); N.C. Gen. Stat. Ann. § 105-153.9; N.D. Cent. Code § 57-38-30.3(4); Ohio Rev. Code Ann. § 5747.05(B); Okla. Stat. Ann. tit. 68, § 2357; Or. Rev. Stat. § 316.082(1); 61 Pa. Code § 111.3; R.I. Gen. Laws 44-30-18; S.C. Code Ann. § 12-6-3400(A)(1); Utah Code Ann. § 59-10-1003; Vt. Stat. Ann. tit. 32 § 5825; Va. Code Ann. § 58.1-332(A); W. Va. Code § 11-21-20; Wis. Admin. Code Tax § 2.955(2).

[13] **Sales and Use**: Ala. Code § 40-23-65; Ariz. Rev. Stat. Ann. § 42-5159(2); Ark. Code Ann. § 26-53-131(a)(1)(A)(i); Cal. Rev. & Tax. Code § 6406; 39 Colo. Code Regs. § 26-713.2(f); Conn. Gen. Stat. Ann. § 12-430(5); D.C. Code Ann. § 47-2206; Fl. Stat. § 212.06(7); Ga. Code Ann. § 48-8-42; Haw. Rev. Stat. § 238-3(i); Idaho Code § 63-3621(j); 35 Ill. Comp. Stat. Ann. 105/3-55(d); Ind. Code Ann. § 6-2.5-3-5; Iowa Admin. Code r. 701-223.2(423); Kan. Admin. Regs. 92-20-15; Ky. Rev. Stat. Ann. 139.510(1); La. Rev. Stat. Ann. § 47:303(A)(3); Me. Rev. Stat. Ann. Tit. 36, § 1862; Md. Code Ann. Tax-Gen § 11-221(c); Mass. Gen. Laws ch. 641, § 7(c); Mich. Stat. Ann. § 205.94(1)(e); Minn. Stat. § 297A.80; Miss. Code

To be sure, there are varying restrictions on these credits, including: 1) resident state sourcing rules, 2) whether the tax paid in one state is similar to the tax paid in another state, and 3) whether the tax is paid by the same taxpayer in the same period on the same type of income. Nonetheless, these credit mechanisms are strikingly similar state by state, and in no way represent an intractable model of federalism or an unwarranted intrusion on state sovereignty as the Comptroller and his *amici* would lead the Court to believe.

B. Maryland Receives a Fair Return for the Services It Provides Without Double Taxation

The Comptroller does not deny Maryland's system results in double taxation of resident individuals and businesses taxed under the individual income tax. The Comptroller seeks to justify his denial of Commerce Clause protections by noting that the States "provide their residents with a host of financial benefits" for which they can ask for a "fair return". Comptroller's Br. 14, 20.

Ann. § 27-67-7(a); Mo. Rev. Stat. § 32.200, Art. V; Neb. Rev. Stat. § 77-2704.31; Nev. Admin. Code § 372.055; N.J. Rev. Stat. § 54:32B-11(6); N.M. Stat. Ann. § 7-9-79(A); N.Y. Tax Law § 1118(7); N.C. Gen. Stat. § 105-164.6(c); N.D. Cent. Code § 57-40.2-11; Ohio Rev. Code Ann. § 5741.02(C)(5); Okla. Stat. Ann. Tit. 68, § 1404(3); 72 Pa. Stat. § 7206(a); R.I. Code R. 60-1-33:1; S.C. Code Ann. § 12-36-1310(C); S.D. Codified Law Ann. § 10-46-6.1; Tenn. Code Ann. § 67-6-507(a); Tex. Tax Code Ann. § 151.303(c); Utah Code Ann. § 59-12-104(26); Vt. Stat. Ann. tit. 32, § 9744(a)(3); Va. Code Ann. § 58.1-611; Wash. Rev. Code § 82.12.035; W. Va. Code § 11-15A-10a(a); Wis. Stat. § 77.53(16); Wyo. Stat. § 39-16-109(d)(iii).

In determining what constitutes a "fair return," the Comptroller opines that Maryland's legislature can craft its own "compromise" solution to balance the state's need for revenue with the requirements of the Commerce Clause. According to the Comptroller, "Here, Maryland has chosen to steer a middle course." Comptroller's Br. 23.

Leaving aside the Comptroller's unilateral action in reinterpreting what is required under the Commerce Clause prohibition against multiple taxation of interstate commerce, his argument ignores the actual facts in this case. In the year at issue, the Wynnes earned income from two sources: their salaries (including Mr. Wynne's salary as president of Maxim) and his flow-through share of Maxim's income, based on his 2.4 percent ownership of the company. Pet. for Cert. App. 56, 86. The Wynnes paid Maryland income tax in full on their salary income, as no other state taxed that income. The only credits taken were for Mr. Wynnes' flow-through income from Maxim, which both parties concur was earned and subject to tax in 38 other states. Comptroller's Br. 5; Wynne Br. 7.

The Wynnes in the year at issue paid more than $126,000 in Maryland income taxes on their salary income and their distributive share of Maxim's income. Pet. for Cert. 4. In addition, they paid other taxes in Maryland (*e.g.*, property and sales/ use taxes). It is difficult to fathom how the Comptroller thinks the Wynnes get a "free ride" unless they are double taxed on their share of the business income earned by Maxim in 39 states. Comptroller's Br. 26.

Nothing in the record suggests the Wynnes or Maxim made any efforts to structure their tax affairs to take advantage of any tax "loopholes." This is just a plain vanilla case of taxpayers who fully complied

with the laws of their home state and 38 other states—only to have their home state of Maryland seek to double tax them while reaping the benefit of taxes received from nonresidents on their Maryland source income (including nonresident shareholders of Maxim itself).

In making a determination of what constitutes a "fair return" from a multistate taxpayer, the Comptroller misses one of the central points of business taxation in today's system—that most of it comes from taxes other than income tax. In FY2013, individual income taxes on business income and corporate income taxes accounted for only 13.4 percent of all state and local business taxes. Ernst & Young/COST, *Total State and Local Business Taxes* 3 (Aug. 2014). Property taxes on business property (36.1 percent) and general sales taxes on business inputs (20.8 percent) made up a much larger share of total state and local business taxes. *Id.* Furthermore, in FY2013, business taxes (*e.g.*, property, sales, income, unemployment insurance, excise, business license) accounted for 44.9 percent of all state and local taxes—a far cry from the "free ride" suggested by the Comptroller in terms of business support for the cost of government services. *Id.* at 1, 12.

C. A Reversal of the Decision Below Would Create a Discriminatory Two-Tier System for Taxing Interstate Commerce

In the final analysis, the problem confronting this Court is not an unworkable and intractable "credit" framework that denies a state sovereignty over its tax system and an adequate revenue base; rather, it is the discriminatory two-tier system that could develop if the Maryland Court of Appeals decision is overturned.

If this Court decides the Commerce Clause protection against multiple and discriminatory taxation does not apply to the taxation of business income earned by S corporations or other entities taxed under the individual income tax, the floodgates will open. This Court will allow states to create bifurcated systems whereby business entities taxed under a corporate income tax would have constitutional protections against double taxation but business entities taxed under the individual income tax would not.

This outcome is particularly disturbing given the significant shift of business activity over the last three decades away from C corporations taxed under the corporate income tax towards S corporations, partnerships and sole proprietors taxed under the individual income tax. In 1980, 11 percent of all state and local taxes paid on business income were collected under the individual income tax (*e.g.*, S Corporations, partnerships and sole proprietors) compared to 89 percent collected under the corporate income tax.[14] By contrast, in 2013, 41 percent of all taxes paid on business income was collected under the individual income tax compared to 59 percent under the corporate income tax.[15] Stated in dollar amounts, $1.7 billion in taxes on business income was collected under the individual income tax in 1980, compared to $36.6 billion in 2013.[16]

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[14] Ernst & Young/COST, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2013*, http://www.cost.org/WorkArea/DownloadAsset.aspx?id=87982 (1980 numbers based on Ernst & Young analysis of IRS Statistics of Income data).

[15] *Id.*

[16] *Id.*

In 2007, only 1.9 million businesses in the U.S. were C corporations, compared to 30.2 million S corporations, partnerships, and sole proprietorships.[17] Moreover, as with tax revenues, the share of C corporations as a percentage of all business entities has been steadily declining for several decades, dropping from 16.6 percent of all businesses in 1980 to 5.8 percent of all businesses in 2007.[18]

Thus, the outcome argued for by the Comptroller—that the Commerce Clause be limited to businesses taxed under the corporate income tax and not be applied to individuals and businesses taxed under the individual income tax—would result in a huge disparity in the treatment of taxpayers. Over 90 percent of all business entities could be denied Commerce Clause protection from double taxation on income earned in multiple states.

Maryland is currently an outlier among the states in denying a full credit for taxes paid to other states, but a ruling by this Court in favor of the Comptroller may encourage other states to similarly protect their revenue base and favor intrastate commerce by denying credits for taxes paid to other states.

Whether a business chooses to operate as a C corporation, S corporation, partnership, sole proprietorship or some new form of entity created in the future does not remove it from the protections of the U.S. Constitution. Similarly, whether a state chooses to tax business income under a corporate income tax, a corporate franchise tax, a gross income tax, a

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[17] Annette Nellen, *Data on Different Types of Business Entities*, http://www.cob.sjsu.edu/facstaff/nellen_a/Data_Different_Types_Business_Entities.pdf (Based on IRS, Integrated Business Data).

[18] *Id.*

margins tax or an individual income tax is not of constitutional import. All come within the embrace of the Commerce Clause. To hold otherwise, and reverse the Maryland Court of Appeals decision, would turn Commerce Clause case law upside down and upset decades of conventional wisdom on the limits of a state's taxing power in situations involving income earned and taxed in multiple jurisdictions.

As discussed above, this outcome would ironically provide larger corporations taxed under the corporate income tax more protection than smaller businesses and sole proprietorships taxed on their business income under an individual income tax.

CONCLUSION

To ensure the Commerce Clause protections against double taxation apply to all income taxes, this Court should affirm the Maryland Court of Appeals decision.

Respectfully submitted,

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AMICUS CURIAE BRIEF

AMER
RECORDS
AND
BRIEFS

Supreme Court, U.S.
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Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,

Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

On Writ of Certiorari to the Court of Appeals for Maryland

BRIEF OF THE INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION AND OTHER STATE AND LOCAL GOVERNMENT GROUPS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST[1]

Amici curiae respectfully submit this brief to protect the sovereign interests of state and local governments—including thousands of counties, cities, townships and other municipalities—that need flexibility to raise revenues to fund vital benefits and services that are enjoyed primarily, if not exclusively, by their residents. *Amici* urge this Court not to extend principles designed to protect non-residents from overreaching local taxation to the distinct context of taxes on residents, where there is no overreaching, no political process problem, and no need for courts to constitutionalize an area where flexibility and the need to respond to local conditions are paramount.

Established in 1935, the International Municipal Lawyers Association (IMLA) is the oldest and largest association of attorneys representing United States municipalities, counties and special districts. IMLA's mission is to advance the responsible development of municipal law through education and advocacy by providing the collective viewpoint of local governments around the country on legal issues before the United States Supreme Court, the United States Courts of Appeals, and in state supreme and appellate courts.

The National Conference of State Legislatures (NCSL) is a bipartisan organization that serves the

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[1] No counsel for any party authored this brief in whole or in part and no entity or person, aside from *amici curiae*, their members, and their counsel, made any monetary contribution toward the preparation or submission of this brief. Counsel of record for all parties have consented to this filing in letters on file with the Clerk's office.

legislators and staffs of the nation's 50 States, its Commonwealths, and Territories. NCSL provides research, technical assistance, and opportunities for policymakers to exchange ideas on the most pressing state issues. NCSL advocates for the interests of state governments before Congress and federal agencies, and regularly submits *amicus* briefs to this Court in cases, like this one, that raise issues of vital state concern.

The National League of Cities (NLC) is the oldest and largest organization representing municipal governments throughout the United States. Its mission is to strengthen and promote cities as centers of opportunity, leadership, and governance. Working in partnership with 49 State municipal leagues, NLC serves as a national advocate for the more than 19,000 cities, villages, and towns it represents.

The U.S. Conference of Mayors (USCM), founded in 1932, is the official nonpartisan organization of all United States cities with a population of more than 30,000 people, which includes over 1,200 cities at present. Each city is represented in the USCM by its chief elected official, the mayor.

The National Association of Counties (NACo) is the only national organization that represents county governments in the United States. NACo provides essential services to the nation's 3,069 counties through advocacy, education, and research.

The International City/County Management Association (ICMA) is a nonprofit professional and educational organization of over 9,000 appointed chief executives and assistants serving cities, counties, towns, and regional entities. ICMA's mission is to

create excellence in local governance by advocating and developing the professional management of local governments throughout the world.

The Government Finance Officers Association (GFOA) is the professional association of state, provincial, and local finance officers in the United States and Canada. The GFOA has served the public finance profession since 1906 and continues to provide leadership to government finance professionals through research, education, and the identification and promotion of best practices. Its 18,000 members are dedicated to the sound management of government financial resources.

The Maryland Association of Counties (MACo) serves Maryland's 23 Counties and Baltimore City by articulating the needs of local government to the Maryland General Assembly. Although MACo does not regularly advocate in the courts, it has made an exception in this case because of the profound ramifications of the Court of Appeals' decision on MACo's member jurisdictions.

SUMMARY OF ARGUMENT

It is well-settled that the unique relationship residents have with the place they call home justifies a state or local government taxing "all income of their residents, including income earned outside their borders." *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 463 n.12 (1995); *e.g.*, *N.Y. ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937). While the possibility that jurisdictions may overreach when taxing non-residents has prompted a long line of cases from this Court addressing allocation of non-resident income to a taxing jurisdiction, there is no comparable concern

regarding non-discriminatory taxation of residents' income: There is no possibility of overreach because a resident's entire income is already within reach, and the political process provides residents an ample check "against erroneous and oppressive taxation," *McCulloch v. Maryland*, 17 U.S. 316, 428 (1819).

State and local governments "giv[e] security to life, liberty and the other privileges of dwelling in a civilized community," *Maguire v. Trefry*, 253 U.S. 12, 14 (1920) (quotation marks omitted), including a wide array of vital public benefits—such as free public schools—that are enjoyed primarily, if not exclusively, by residents. To pay for those services, state and local governments need flexibility to determine the optimal mix of taxes, whether they be levied on income, sales, real property, personal property, or otherwise.

It is an inherent feature of our federalism that people can live in one place and earn money in another. This Court in turn has recognized that a jurisdiction's treatment of its own residents' out-of-jurisdiction income generally is not a constitutional question for the courts but an "independent policy decision" for state and local governments to decide. *Chickasaw Nation*, 515 U.S. at 463 n.12 (quotation marks omitted). Jurisdictions can and sometimes do provide a tax credit for taxes paid by residents on income generated in other jurisdictions. *Id.* But to raise the same revenue while providing such a foreign income tax credit,[2] a state or local government must

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[2] This brief uses the phrase "foreign income taxes" to refer to all income taxes paid to jurisdictions other than to those where the taxpayer resides. The decision below involves taxes paid to

increase the income tax rate or raise other taxes—and the potential alternatives tend to be more regressive and all involve different trade-offs and different perceived inequities.

For example, giving a full dollar-for-dollar credit for foreign income taxes avoids the inequity of two neighbors having different tax burdens even though they earn the same income. But a full credit simultaneously creates a different inequity: A neighbor with substantial foreign income will contribute substantially less to pay for local services like schools than the otherwise identically-situated neighbor earning all her income in-state, even though both take equal advantage of local services. And to counterbalance the foreign tax credit, the local jurisdiction will need to raise some other tax, which will fall disproportionately on some other neighbor and often be more regressive.

The Constitution does not demand a single bright-line answer to what is at bottom a complex policy question for state and local officials. A jurisdiction can offer its residents a full credit for foreign taxes paid, a partial credit (for example, phased out for high-income individuals), a deduction (in full or in part), or no

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other States, but taxes paid to other countries present the same issues of tax policy. To the extent the law here implicates the domestic Commerce Clause, it would similarly implicate the foreign Commerce Clause. *See Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 451 (1979). This brief uses "dollar-for-dollar" to describe the credit Respondents demand, which is for every single dollar in income tax they paid to other States that they would otherwise owe to Maryland and Howard County on income earned in those States. *See* Comptroller Br. 4 & n.3; U.S. Br. 2.

credit at all without running afoul of any principle enshrined in the Constitution. Maryland rationally chose a compromise position, providing a full credit at the state level but no credit at the county level. That choice does not cross any constitutional line.

In our system of federalism, each of the co-equal States is generally free to organize its affairs as its people determine through the democratic process. Indeed, deciding how to structure taxes on residents is a quintessential policy judgment for each of the several States and its subdivisions. Although the Supremacy Clause ensures that the U.S. Constitution and federal laws and treaties can trump State laws, there is no "horizontal supremacy clause" providing that one State's lawful exercise of its jurisdiction must defer to a sister State's exercise of jurisdiction over that same person, particularly when the person lives in the first State and merely works or invests in the other. The Maryland Court of Appeals seriously erred in misreading the Commerce Clause as a warrant to break from that constitutional tradition, and its decision should be reversed.

ARGUMENT

I. Neither The Constitution Nor Considerations Of Sound Tax Policy Demand A Full Dollar-For-Dollar Credit For Foreign Income Taxes Paid.

A. State and Local Governments Provide Residents With Extensive and Unique Benefits.

State and local governments provide vital protections and services that directly impact the lives of their residents virtually every day. They provide

police and fire protection to protect life, liberty, and property; medical care to keep people healthy; roads, bridges, and mass transportation to help people get from place to place; they deliver the water we drink; they enforce environmental laws to ensure that water is pure and that the air we breathe is clean; they support the unemployed and needy; and they ensure equal access to the state and local courts. All of these critical services cost money. *See Compania General de Tabacos v. Collector*, 275 U.S. 87, 100 (1927) ("Taxes are what we pay for civilized society...."); Jeffrey L. Barnett & Phillip M. Vidal, *State and Local Government Finances Summary: 2011*, U.S. Census Bureau 3–4 (July 2013), http://perma.cc/96AY-8S9M ("State Survey") (summarizing costs). And although many of these benefits are available generally to any person who sets foot in the State or municipality, because they are provided locally they provide the greatest benefit to people who are there most often and have decided to call that place home: residents.

State and local governments provide some important benefits *exclusively* to residents, with public education being one of the most important (and expensive) examples. Here, for example, Respondents have five school age children, all of whom could enjoy the privilege of a free top-quality education from kindergarten through high school, followed by discounted in-state tuition at a public university. *See Frankel v. Board of Regents*, 761 A.2d 324, 326 (Md. Ct. App. 2000). Roughly 57% of the Howard County budget goes to public education. Howard County, *Fiscal Year 2014 Approved Operating Budget Detail* 5 (2013), http://perma.cc/J4Y9-G7QX ("County Budget"); *see also id.* at 11 ("Nothing is more

important than our obligation to the education of our children. It is the bedrock of the Howard County experience."). Maryland similarly devotes 36% of its budget to public education. Md. Dep't of Budget & Mgmt., *Budget Highlights FY 2014* at 6 (Jan. 16, 2013), http://perma.cc/KLA6-LZR4 ("State Budget") (22% from income tax); *see also id.* at iii ("With record investments, we have built the best public school system in America.").

Maryland residents are also exclusively entitled to Maryland's Medicaid coverage and certain other health care benefits. *See* Md. Code Regs. 10.09.24.05-3(A). Many forms of public assistance are likewise available exclusively to residents. *See, e.g.*, Md. Code Regs. 07.03.07.03(A)(1), 07.03.17.08(A)(2), 07.03.21.03(A)(1). Maryland's practices in this regard are typical, as other state and local governments similarly dedicate extensive resources to public education, health care, and support for the indigent. *See* State Survey at 7 tbl. A-1.

Residents also exclusively enjoy one other unique privilege that directly informs the constitutional issues at stake here: Only residents enjoy the right to vote. Md. Const. Art. I, § 1. "It is beyond cavil that 'voting is of the most fundamental significance under our constitutional structure.'" *Burdick v. Takushi*, 504 U.S. 428, 433 (1992) (quoting *Ill. Bd. of Elections v. Socialist Workers Party*, 440 U.S. 173, 184 (1979)). Unlike non-residents who have no direct say in setting another State's tax policies, residents can vote to change them. Thus, whereas there are structural reasons to be wary of taxes on non-residents, there is no comparable concern regarding policies directed at

residents and instead every reason to defer to the political process.

States and local governments have a variety of options for raising the revenue necessary to pay for the critical services that primarily or exclusively benefit residents. Sales taxes and real property taxes are important options that account for much state and local revenue. State Survey at 3. The vast majority of States—43 plus the District of Columbia—also fund their operations at least in part through a tax on their residents' net income. Scott Drenkard & Joseph Henchman, *2014 State Business Tax Climate Index*, Tax Foundation 16–17 (Oct. 2013), http://perma.cc/9MGC-DSDJ. Nearly 5,000 state subdivisions—counties, cities and special districts around the country, with a total population of more than 23 million—have made the same choice. Joseph Henchman & Jason Sapia, *Local Income Taxes*, Tax Foundation (Aug. 31, 2011) http://perma.cc/ZG28-33DH. Each of Maryland's counties assesses an income tax, at rates from 1.25% to 3.2%. *Id.* So too do Indiana's 92 counties, assessing income taxes at rates up to 3.13%. *Id.* In Ohio, 593 municipalities and 181 school districts assess such a tax, as do 2,469 municipalities and 469 school districts in Pennsylvania. *Id.* New York City, Birmingham, Detroit, San Francisco, and numerous other cities nationwide also levy taxes on income. *Id.*

Raising revenues through a tax on net income has the advantages of having a broad tax base and being more progressive than alternatives. *See* Inst. on Taxation & Econ. Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States* 1

(4th. ed. Jan. 2013), http://perma.cc/LT9K-T83U ("Distributional Analysis") ("Of the three broad kinds of taxes states levy (income, property, consumption), the income tax is the only one that is typically progressive in that its rate rises with income levels."). There are, of course, lively policy debates about the extent to which taxes should be relatively progressive or relatively flat. But the Constitution is agnostic about that debate. *Brushaber v. Union Pac. R.R.*, 240 U.S. 1, 24–26 (1916); *see also Lochner v. New York*, 198 U.S. 45, 75 (1905) (Holmes, J., dissenting) (The Constitution "does not enact Mr. Herbert Spencer's Social Statics."). Moreover, unlike property taxes which local governments often administer themselves, local income taxes can "piggyback" on the State's income tax system. Tax Policy Ctr., *Residential Property Taxes in the United States* 2 (Nov. 18, 2013), http://perma.cc/6XBE-TFZT. The option of imposing an income tax on residents' net income is thus an important option for jurisdictions seeking to avoid regressive means of raising revenues.

Where imposed, income taxes are critical to balancing state and local budgets. For example, in fiscal year 2014, the state and county income taxes in Maryland and Howard County are projected to raise nearly 25% of each government's revenue. State Budget at 6 (22% from income tax); County Budget at 4 (23%). Again, this is typical of state and local governments that levy income taxes. *See* State Survey at 6 tbl. A-1 (21.3% of state and local tax revenue from individual income taxes).

B. Any Approach to Foreign Income Taxes Has Policy Advantages and Disadvantages

Because "income may be taxed both by the state where it is earned and by the state of the recipient's domicile," *Curry v. McCanless*, 307 U.S. 357, 368 (1939), state and local governments must make an "independent policy decision" about how to address this overlapping tax jurisdiction and the potential for double taxation, *Chickasaw Nation*, 515 U.S. at 463 n.12. Any approach to this issue presents policy advantages and disadvantages.

At the outset, a number of policy justifications rationally support a decision to decline to provide a credit for income taxes paid to foreign jurisdictions. A no-credit regime is simpler for residents to comply with because they need not document the taxes paid to foreign jurisdictions. It is easier for the government to administer because it need not verify the reported amount or determine which foreign taxes constitute creditable "income taxes." *Cf.* 26 C.F.R. § 1.901-2 (2013) (exhaustively distinguishing income taxes from other non-creditable taxes); *PPL Corp. v. Comm'r*, 133 S. Ct. 1897 (2013) (providing an example of the difficult questions that can arise). The no-credit approach raises the same revenue from all residents with the same income. *See infra*. And it avoids the need to raise rates or other taxes to recoup the substantial cost of a full credit. *E.g.*, Md. Dep't of Budget & Mgmt., *Tax Expenditures Report, Fiscal Year 2014* 51 (Feb. 2013), http://perma.cc/SH5P-T99W (Maryland's state-level credit costs more than $200 million per year).

The Maryland Court of Appeals emphasized that by declining to provide a full dollar-for-dollar foreign tax credit, Maryland produced an inequity: If a Maryland resident pays foreign income tax, her effective tax rate will be higher than another resident who earns the same overall income but does not pay foreign income tax because she earns income only in Maryland or in jurisdictions without an income tax or that do not tax Maryland residents' income, such as through a tax reciprocity agreement. Pet. App. 16. The court observed that this "creates a disincentive for the taxpayer—or the S corporation of which the taxpayer is an owner—to conduct income-generating activities in other states with income taxes." *Id.*[3]

But while the Maryland Court of Appeals is correct that a no-credit system creates this potential inequity, there is no perfect tax system and no platonic mode of dealing with foreign taxes such that all inequities are avoided. Indeed, correcting the potential inequity the Maryland Court of Appeals identified by providing a full dollar-for-dollar credit, as Respondents demand, can only be done by creating other potential inequities. *Cf. Logan v. United States*, 552 U.S. 23, 33 (2007) (declining to interpret a statute to avoid "anomalous results" when that "would correct one potential anomaly while creating others").

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[3] This "disincentive" theory also proves too much, as it can equally be said that a State that taxes non-resident income "creates a disincentive for the taxpayer ... to conduct income-generating activities" there. Indeed, if the foreign jurisdiction has no income tax or chooses not to tax Maryland residents' income, there is no disincentive at all.

First, with a full dollar-for-dollar foreign tax credit, a Maryland resident with substantial foreign income will contribute less toward local services than a neighbor with the exact same net income but no foreign income taxes paid. For example, if a family lives in Howard County, sends two children to the local public schools, and earns $200,000 a year in Maryland or jurisdictions that do not tax Maryland residents' income, the family would pay income tax to the State and county on the entire $200,000. But with a full dollar-for-dollar foreign tax credit, the family next door with the same income and two children at the same school would pay less to support those very same services if it earned part of its income in foreign jurisdictions that taxed Maryland residents' income. Indeed, if the income was earned in New York, New Jersey, or other jurisdictions that tax income at or above the combined Maryland and Howard County rate (7.95% in 2006), the out-of-state earner could pay little or no state or county tax at all. *See Comptroller of Treasury v. Blanton*, 890 A.2d 279, 284 n.9 (Md. Ct. App. 2006) (describing as "possibl[y] absurd" the prospect of one family "paying little or no local tax for the services provided by the county while a neighbor with similar income, exemptions, and deductions might be paying a substantial local tax to support those services").

Thus, with or without full dollar-for-dollar foreign tax credits, there will be inevitable disparities between similarly situated taxpayers. There are sound policy arguments for imposing the same overall tax burden on two taxpayers with the same net income, and there are sound policy arguments for imposing the same obligation to fund local services on

two taxpayers with the same net income. But there is no sound argument for constitutionalizing the issue and taking this policy judgment away from state and local lawmakers.

Second, it is no accident that the taxpayers who demanded credits here reported a high income. Non-refundable tax credits are generally regressive because they are valuable only to the extent a person has tax liabilities to offset, and many people who have foreign income (particularly through investments) have relatively high incomes. *See* Roberton Williams, *How Some High-Income People Avoid Paying Federal Income Tax*, Forbes (Sept. 5, 2013), http://perma.cc/MZB9-HBGP ("High-Income Tax Avoidance") (in 2010 thousands of taxpayers earning over $200,000 used the federal foreign tax credit to avoid all federal income tax liability).

The possibility of high-earning taxpayers offsetting substantial parts of their state and local income tax burden means that they may pay less to support state and local public services than not just their similarly-situated neighbors, but also their neighbors who are considerably less fortunate. To take an extreme example, if Respondents had earned $2.7 million in jurisdictions that taxed Maryland residents' income at 7.95% or higher, they could potentially zero out their state and local tax liability—yet another Howard County resident earning only $27,000 in Maryland or jurisdictions that do not tax Maryland residents' income would pay $1136 to the State and $800 to the county after a standard deduction. *See Maryland 2006 State & Local Tax Forms & Instructions* 19 (2006), http://perma.cc/7JTB-

8CXW. The person living paycheck-to-paycheck thus would be cross-subsidizing the wealthy family's enjoyment of important state and local services. The Constitution surely does not force that policy choice on States and localities.

Third, to counteract the foregone revenue of a foreign tax credit, a State or locality would need to raise revenue elsewhere. Indeed, extending a full dollar-for-dollar tax credit to Respondents alone could cost Howard County tens of thousands of dollars, *see* Pet. App. 56, and the net effect could reduce overall personal income tax collections "by $45,000,000 to $50,000,000 annually in future tax years." Pet. 15. That lost revenue would need to be made up for by increasing tax burdens elsewhere, and the alternatives tend to be regressive.

For example, Respondents suggest that the State could "[r]aise all residents' county tax rates" or "increas[e] sales or property taxes." Opp. 23. But raising income tax rates across the board would simply foist the cost of the credits on Respondents' neighbors who do not pay foreign income taxes, which would exacerbate the inequities described above and likely be regressive. *See* High-Income Tax Avoidance, *supra*. Increasing property taxes would likely be "somewhat regressive," as "poor homeowners and renters pay more of their incomes in property taxes than do any other income group—and the wealthiest taxpayers pay the least." Distributional Analysis at 6. And increasing sales or excise taxes would be "very regressive," as "[p]oor families pay almost eight times more of their incomes in these taxes than the best-off

families, and middle-income families pay more than five times the rate of the wealthy." *Id.*

It is one thing for a jurisdiction to provide a full foreign tax credit based on policy views about avoiding so-called double taxation or certain forms of perceived inequity. It is quite another for courts to force that policy judgment on States and localities. Indeed, constitutionally compelling such a full tax credit would countermand both the democratically-arrived policy judgment not to extend a full foreign tax credit and many other judgments as well. Respondents would not only pay less to support their local government, but other residents would have to pay *more*—and that additional tax burden would be levied in ways that state and local elected officials determined were undesirable.

C. Providing a Partial Foreign Income Tax Credit Is a Rational and Fair Response to This Difficult Policy Problem

Faced with policy tradeoffs either way, it is rational for a state or local government to resolve the competing equitable claims by declining to provide a foreign income tax credit and thus ensuring that two local taxpayers with the same income make the same contribution to local government services. It is also rational for a state or local government to give a dollar-for-dollar credit and thus prevent its residents from having a higher overall tax burden if they happen to earn income that is taxed by other jurisdictions, and to make a policy decision about where best to raise the lost revenue. It would be equally rational to provide a partial credit, a credit that is phased out at certain income thresholds, a deduction, or any number of

other approaches. Maryland, for its part, chose another rational compromise. Maryland gives a full credit against the larger State portion of the income tax (here, a 4.75% marginal rate) but not the smaller county portion (here, 3.2%). Maryland thus protects its residents from at least 60% of any foreign income tax they pay, and perhaps more depending on the foreign tax rate. Beyond that point, Maryland requires residents to pay county income tax to support the local services they enjoy. Maryland thus gains some of the upsides (and some of the downsides) of each approach.

Many other state and local governments have made similar choices to provide residents partial credits for foreign income taxes paid. For example, Wisconsin and North Carolina provide credits for state-level foreign income taxes but disallow credits for city, county and local foreign income taxes. *See* Wisc. Admin Code Tax § 2.955; N.C. Gen. Stat. § 105-153.9(a)(1). Tennessee denies a credit for income taxes paid by a resident Subchapter S income derived from States that do not have tax reciprocity with Tennessee. *Boone v. Chumley*, 372 S.W.3d 104, 108–11 (Tenn. Ct. App. 2011).

Many municipal governments impose taxes on residents' net income without a full credit for taxes paid in other States. For example, in New York State, two cities (New York City and Yonkers) impose an income tax. *See* N.Y. Tax Law § 1301. And although a foreign tax credit is provided against the state-level income tax, no credit is provided against this municipal income tax. *Compare* N.Y. Tax Law § 620, *with* N.Y. Tax Law § 1310. Similarly, "[n]on-residents

of Pennsylvania cannot claim a tax credit against Philadelphia Earnings Tax for income taxes paid to any other state or political subdivision. Residents of Philadelphia employed outside of Pennsylvania may be required to file and pay a local income tax in that jurisdiction in addition to Philadelphia Earnings Tax." City of Phila. Dep't of Revenue, *Earnings Tax*, http://perma.cc/8MB9-F764. Cleveland, Detroit, Indiana's counties, Kansas City, St. Louis, and Wilmington, Delaware have similar laws.[4]

These decisions about whether to provide a tax credit against certain local taxes not only reflect a complex policy judgment about the appropriate mix of taxes and treatment of competing equities, but also a judgment about the nature and purpose of the tax. For example, at the state level Maryland endeavors to tax all income earned in the State: The State taxes residents' income, non-residents' income earned in Maryland, and corporate income allocated to Maryland. *See* Md. Code Ann., Tax-Gen §§ 10-102, 10-203, 10-210(b), 10-301. But the county tax is more limited. There is no county corporate income tax; the county tax applies only to individuals. *See id.* §§ 10-103, 10-101(j), (k). The counties also do not tax the income of most non-residents who work there. Counties do not tax the income of residents of other Maryland counties, *id.* § 10-103(a), and they only tax

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[4] *See Municipal Income Tax*, http://perma.cc/99XF-D4RG (Cleveland); Mich. Comp. Laws § 141.601-99; John Eckart, *General Information on County Income Taxes* (July 2008), http://perma.cc/BV4N-5GGK; *Wage Earner Return Earnings Tax*, http://perma.cc/D5VU-GD2V; St. Louis, Mo. Code Ch. 5.22; City of Wilmington, *Earned Income Tax*, http://perma.cc/JNL9-HMMD.

the income of non-residents who happen to live in a locality that would itself tax the income of a Maryland resident working there without providing a credit or otherwise exempting the income, *id.* §§ 10-103(a)(4), 10-806(c). Nine States have such localities, and notably the bordering States of Virginia, West Virginia, Pennsylvania, Delaware, and the District of Columbia are not among them. See Comptroller of Md., *Nonresident Income Tax Rate*, http://perma.cc/H629-32V5. Howard County thus taxes neither the wages of a Baltimore County resident nor a Virginia resident who works in Howard County. Thus, rather than seeking to tax all income earned locally, the county primarily uses its residents' net income as a proxy for the extent to which residents have the ability to pay for the local services they enjoy. In light of the different nature of the two taxes, it is rational to provide a credit against the former but not the latter.

At bottom, any tax system will generate perceived inequities and policy tradeoffs and it is the function of state and local governments to make difficult judgments about the competing interests and to face the voters. A property tax to fund local schools has a potentially inequitable effect on those who lack school-age children or must devote more of their income to housing. A tax on personal property has a potentially inequitable effect on those who collect cars instead of stamps. Some would advocate a flat tax, which is equitable in some ways but would be far more regressive. Maryland's compromise approach in turn is rational and fair. The fact that there are competing equitable claims is thus an unavoidable reality, not an

excuse for courts to craft a new bright-line rule without mooring in the Constitution.

II. The Novel Ruling Below Violates State Sovereignty And Misreads This Court's Precedents

1. The Maryland Court of Appeals' sweeping and novel ruling needlessly constitutionalizes a new area of the law, calls into question the democratic judgments made by all the jurisdictions above, significantly undermines State sovereignty, and imposes constitutional rigidity in an area where States and localities need flexibility.

This Court has long recognized that the power to tax is "a necessary instrument of self-government and territorial management." *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 137 (1982); *see also McCulloch*, 17 U.S. at 429 (an "incident of sovereignty"). It is critical for any government "to raise revenue to defray the expenses of government and to distribute its burdens equably among those who enjoy its benefits." *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 279 (1932). Moreover, because taxes and tax collectors have been unpopular for as long as there have been taxes, governments need considerable flexibility to choose among rational policy alternatives.

Striking the right balance between the proper level of government benefits and the proper level of tax has always been (and always will be) a matter of intense political debate. This Court in turn has recognized that the resolution of those debates is generally reserved for the people—not the judiciary—through the democratic process. *E.g.*, *Shaffer v. Carter*, 252 U.S. 37, 51 (1920) ("The rights of the

several States to exercise the widest liberty with respect to the imposition of internal taxes always has been recognized in the decisions of this court."); *Lunding v. N.Y. Tax Appeals Tribunal*, 522 U.S. 287, 297 (1998) ("considerable discretion"); *Madden v. Kentucky*, 309 U.S. 83, 88 (1940) ("large area of discretion").

Structuring a state or local tax code thus involves quintessential policy judgments that our Constitution reserves for state and local elected officials. Those officials must decide how much revenue to raise with what kinds of taxes—Sales taxes? Property taxes? Income taxes? Gross receipts taxes? Corporate income taxes?—and they must make a host of policy decisions as to any particular tax: What should the rate be? How broad or narrow should the tax base be? How should the tax be assessed and enforced? What exemptions should be applied? Should credits or deductions be allowed? Should the tax be subject to a floor? A ceiling? The possibilities are endless, and virtually any decision pleases some constituents while upsetting others. Courts should be loath to craft new constitutional rules that embroil them in this policy thicket and encourage further litigation.

The Maryland Court of Appeals' novel venture is particularly pernicious because it deprives one State of authority to tax its own residents' income based on a sister State's exercise of its own authority to tax non-residents' income. *See* U.S. Br. 10–12. Our Constitution has no "horizontal supremacy clause" forcing any one State to defer to another, much less to command the bizarre result that the State where a person *lives* must defer to a State where she merely

invests. The Constitution does not embrace a particular theory of taxation such that claims to tax all of a resident's income must yield to a competing claim to tax income-generating activities of a non-resident. Instead, each of the fifty States is generally free to operate as a laboratory of democracy, exercising its independent judgment about how to govern itself without restriction or limitation by another State's parallel conduct. *Cf. State Tax Comm'n of Utah v. Aldrich*, 316 U.S. 174, 181 (1942) ("[T]here is no constitutional rule of immunity from taxation of intangibles by more than one State."); *Bartkus v. Illinois*, 359 U.S. 121, 128–31 (1959) (no constitutional immunity from criminal prosecution by more than one State).

2. The Due Process Clause and the Commerce Clause provide no support for Respondents' novel rule that the Constitution compels a particular kind of tax relief (a credit, not a deduction) at a particular level (a full 100% credit and not a dollar less) when its residents pay foreign income taxes. First, Respondents have sufficient contacts with the jurisdiction to justify taxation of their entire income as a matter of Due Process: Howard County is their home. *Shaffer*, 252 U.S. at 57 ("As to residents [a State] may, and does, exert its taxing power over their income from all Sources, whether within or without the state."); *cf. Goodyear Dunlop Tires Operations, S.A. v. Brown*, 131 S. Ct. 2846, 2851 (2011) (a State may exercise general jurisdiction even over a foreign corporation if it is "essentially at home in the forum State"). This hoary Due Process principle reflects both the close relationship between a resident and her state and local government, and the reality that when a

State or locality taxes its residents, it "acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation." *McCulloch*, 17 U.S. at 428.

The tax is also consistent with the Commerce Clause. This Court's dormant Commerce Clause jurisprudence protects against discriminatory taxation, *e.g.*, *S. Cent. Bell Tel. Co. v. Alabama*, 526 U.S. 160, 169–70 (1999), but this Court has never suggested that there is a constitutional right to an exemption from a tax that is neutral and generally applicable. Indeed, in *Shaffer*, a non-resident relied on the Commerce Clause and Privileges and Immunities Clause to demand an exemption from a neutral and generally applicable tax law—and this Court squarely rejected the demand. *See Shaffer*, 252 U.S. at 53–58 ("no right to be favored by discrimination or exemption"); *cf. Employment Division v. Smith*, 494 U.S. 872 (1990) (First Amendment does not guarantee exemptions from neutral and generally applicable laws). The tax here is strictly neutral and any impact it has on interstate commerce is just as incidental as its impact on intrastate—and international—commerce: It taxes all of a resident's income equally.

If any further inquiry is required, at most there must be some minimal justification for the tax based on its connection to local benefits. *See Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) (burden on interstate commerce may not be "clearly excessive in relation to the putative local benefits"); *Williamson v. Lee Optical of Okla.*, 348 U.S. 483 (1955) ("It is enough that there [be] an evil at hand for correction, and that

it might be thought that the particular legislative measure was a rational way to correct it."). For the reasons set forth above, the law here satisfies any such inquiry. State and local governments provide their residents with unique and extensive benefits that justify taxation, net income is a rational tax base, and a fixed-percentage tax on the net income of all residents, without credits for foreign income taxes paid, is not "clearly excessive" to the benefits of county residency. Maryland could opt for a different approach. It could provide full credits against county income taxes with corresponding increases in other taxes. But optimal or suboptimal from a policy perspective, Maryland's approach satisfies any applicable constitutional test.

3. The Maryland Court of Appeals mistakenly extended *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), which holds that it is not *per se* unconstitutional to apply a tax on the privilege of doing business against a non-resident corporation engaged solely in interstate activity. *Id.* at 289. The validity of such a tax depends not on its label but its function, including whether it is "fairly apportioned." *Id.* at 279.

But *Complete Auto* does not logically extend to taxes on *residents* or hold that apportionment is a free-standing requirement of all state taxes in all contexts. Rather, the apportionment requirement addresses the vulnerabilities of non-residents and attempts to ensure that, when a State taxes a foreign corporation's income, the State is only reaching activity within its jurisdiction and not purely extraterritorial activity (as familiar Due Process principles require) and not

discriminating against out-of-state businesses (as familiar Commerce Clause principles require). *Compare Int'l Shoe Co. v. Washington*, 326 U.S. 310, 320 (1945); *City of Philadelphia v. New Jersey*, 437 U.S. 617, 626–27 (1978). There is no basis for extending an apportionment requirement here, however, because Maryland has already satisfied those familiar constitutional commands without apportionment. Maryland has not reached values beyond its borders; it is taxing its own residents' income. And Maryland does not discriminate against interstate commerce; it taxes all income from all sources equally.

Moreover, this Court has long scrutinized state laws taxing multistate corporations with limited in-state presence because states may have a temptation to obtain out-of-state revenue without in-state costs by stretching their territorial jurisdiction and taxing out-of-state commerce without providing corresponding local benefits. *See, e.g., MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 553 U.S. 16, 25–29 (2008) (recounting the long history of this Court's "unitary business" jurisprudence). For taxation of residents, however, there is no such temptation and every reason to believe that the democratic process already provides adequate protection. Maryland's tax does not free ride on out-of-state commerce. The tax applies only to Maryland's own residents, and thus imposes in-state economic and political costs. The tax is literally paid out of residents' own in-state pockets. If they are displeased with the tax, they may "complain about and change the tax through [the] political process." *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989). Indeed, residents can vote with their feet and move to

another jurisdiction with tax laws they prefer. These political and economic checks provide "sufficient security against erroneous and oppressive taxation," *McCulloch*, 17 U.S. at 428, and the novel interference of the courts is unwarranted.

In short, the animating purposes underlying this Court's allocation jurisprudence are missing here. There is no justification for extending that notoriously imprecise jurisprudence to a context where there is no extraterritoriality, no discrimination, and no incentive to impose disproportionate burdens on non-constituents.

CONCLUSION

For the foregoing reasons, this Court should reverse.

Respectfully submitted,

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August 5, 2014

AMICUS CURIAE BRIEF

No. 13-485

IN THE

Supreme Court of the United States

MARYLAND STATE COMPTROLLER
OF THE TREASURY,

Petitioner,

v.

BRYAN WYNNE, *et ux.*,

Respondents.

ON WRIT OF CERTIORARI TO THE
MARYLAND COURT OF APPEALS

BRIEF OF MICHAEL S. KNOLL AND RUTH MASON AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTIONS PRESENTED

(1) Does the Maryland "county" income tax violate the dormant Commerce Clause by discouraging cross-border commerce in favor of in-state commerce?

(2) If the Maryland "county" income tax violates the dormant Commerce Clause, does the Constitution require Maryland to fully credit the taxes of other states against its "county" tax?

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BRIEF OF MICHAEL S. KNOLL AND RUTH MASON AS *AMICI CURIAE* IN SUPPORT OF AFFIRMANCE

INTEREST OF *AMICI CURIAE*[1]

Amici are tax professors who, based on their expertise in law and economics, conclude that the Maryland personal income tax regime, specifically the Maryland "county" tax, violates the dormant Commerce Clause by discouraging interstate commerce, but that a credit is not the only possible remedy for the breach.

Michael S. Knoll is Deputy Dean and Theodore Warner Professor, University of Pennsylvania Law School; Professor of Real Estate, The Wharton School; Co-director, Center for Tax Law and Policy, University of Pennsylvania. Much of Professor Knoll's recent research focuses on the connections between taxation and competitiveness.

Ruth Mason is Hunton & Williams Professor of Law at the University of Virginia School of Law. Most of her academic work focuses on the meaning of tax discrimination in various legal contexts, including U.S. constitutional law, tax treaties, and European Union law.

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1. No counsel for any party authored this brief in whole or in part and no entity or person, aside from *amici curiae* and their counsel, made any monetary contribution toward the preparation or submission of this brief. Counsel of record for all parties have consented to this filing in letters on file with the Clerk's office.

SUMMARY OF ARGUMENT

The internal consistency test reveals that Maryland applies systematically higher "county" taxes to interstate commerce than to in-state commerce.

Economic analysis of Maryland's tax regime—including its taxes on inbound, outbound, and domestic activities—confirms what the internal consistency test suggests, namely, that the Maryland "county" tax discourages interstate commerce. Specifically, the Maryland tax regime discourages Maryland residents from earning income outside of Maryland, and it simultaneously discourages nonresidents from earning income in Maryland. Maryland alone causes this distortion; the distortion does not depend on the taxes imposed by any other state.

Petitioner's argument that Maryland's outbound tax regime should be upheld because it is facially neutral when compared to Maryland's domestic tax requires the Court to ignore Maryland's inbound tax on nonresidents. Ignoring relevant parts of a state's tax regime obscures the overall effect of that regime on interstate commerce.

Although crediting other states' taxes would cure Maryland's dormant Commerce Clause violation, other practical and legitimate alternatives for curing the violation exist. Maryland, not the courts, should decide how to cure the constitutional infirmity in Maryland's tax regime.

ARGUMENT

I. Maryland's Income Tax Regime Discourages Interstate Commerce

A. The Dormant Commerce Clause Prevents States from Encouraging In-state Commerce at the Expense of Interstate Commerce

The dormant Commerce Clause of the Constitution "is the doctrine that the Commerce Clause, by its own force and without national legislation, puts it into the power of the Court to place limits on state authority." Felix Frankfurter, the Commerce Clause under Marshall, Taney & Waite, 18 (1937). Underlying the Commerce Clause is the framers' "conviction that in order to succeed the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Hughes* v. *Oklahoma*, 41 U.S. 322, 325-26 (1979). Accordingly, "[o]ur [economic] system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation. . . ." *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 539 (1949). As interpreted by this Court, the dormant Commerce Clause prohibits a state from using its tax system to "place[] burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear." *Okla. Tax Comm'n* v. *Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995).

B. Maryland's Tax Regime is Internally Inconsistent

The internal consistency test makes clear that Maryland overburdens, and hence discourages, interstate commerce as compared to purely in-state commerce. Acknowledging the importance of state tax sovereignty, this Court developed the internal consistency test as a standard for when state taxes violate the dormant Commerce Clause. Under the test,

> [i]nternal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every state in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.

Jefferson Lines, Inc., 514 U.S. at 185.

Maryland formally divides its individual income tax into a "state" portion with a maximum rate of 4.75%, and a "county" portion with rates ranging from 1.25% to 3.2%. Md. Code Ann., Tax-General (T.G.) §§ 10-102, 10-103(a)(1). Maryland allows taxes paid to other states to fully offset the "state" portion of the tax, but it disallows any credit against the "county" tax. T.G. § 10-703(a). Since the substance of this dispute concerns only the "county"

tax, we will analyze only the "county" tax.[2] Ignoring the uncontested "state" portion of the tax, the Maryland tax regime contains the following elements:

For residents:

1. On income earned in Maryland, "county" tax of 1.25% to 3.2%, depending on the county of residence (domestic tax) T.G. § 10-103(a)(1)

2. On income earned in other states, "county" tax of 1.25% to 3.2%, depending on the county of residence, against which and there is no credit for other states' taxes (outbound tax) T.G. §§ 10-103(a)(1), 10-703

For nonresidents,

3. On income earned in Maryland, "county" tax (i.e., Special Non-Resident Tax (SNRT)) of 1.25% (inbound tax) T.G. § 10-106.1(a).[3]

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2. The formal division by Maryland of its tax into "state" and "county" taxes has no effect on constitutional analysis. See, e.g., *Nippert v. City of Richmond*, 327 U.S. 416 (1946) (striking down a municipal license tax on business solicitors for violating the dormant Commerce Clause); see also *Frey v. Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011) (concluding that Maryland's "county" income taxes were state taxes for constitutional law purposes).

3. Just as it taxes residents, Maryland subjects nonresidents with Maryland-source income to the 4.75% "state" portion of the Maryland individual income tax, but we ignore the "state" portion of the tax for purposes of this analysis. See T.G. § 10-105(d). In lieu of the SNRT, Maryland subjects nonresidents who receive compensation for employment in Maryland to the "county"

4. On income earned in other states, no tax

The Wynnes resided in Howard County, where the "county" tax rate was 3.2%, so the Wynnes paid "county" tax of 3.2% on their domestic and outbound income. *Figure 1* schematically represents the Maryland "county" tax regime for Howard county.

Figure 1. Maryland "County" Tax Regime

	Maryland Resident	Resident of Another State
Activity in Another State	*Outbound Tax* 3.2%	N/A
Activity in Maryland	*Domestic Tax* 3.2%	*Inbound Tax* 1.25%

The internal consistency test directs us to assume that every state enacts the same tax regime as Maryland, and then the test asks whether, under such hypothetical harmonization, interstate commerce suffers a greater burden than does in-state commerce. *Figure 2* shows how income would be taxed if every state (represented here by Delaware) adopted the Maryland "county" tax as employed in Howard County:

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tax rates ranging from 1.25% to 3.2%. See T.G. § 10-103(a)(4). Nonresidents with Maryland income from sources other than employment pay the SNRT, which Maryland sets equal to the lowest "county" tax rate, 1.25%.

Figure 2. Maryland Tax under Internal Consistency Test

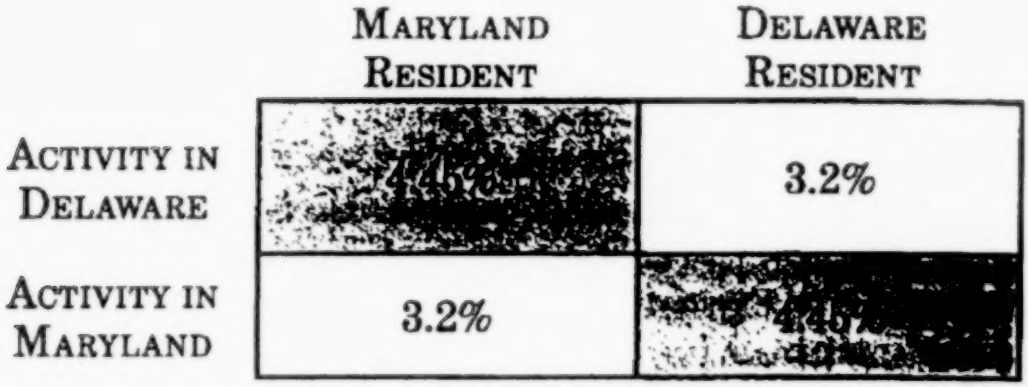

Figure 2 shows that the Maryland "county" tax is internally inconsistent because under hypothetical harmonization in-state income would be taxed at 3.2%, whereas interstate income would be taxed at 4.45%. The shaded quadrants in *Figure 2* represent interstate income, comprising Maryland income earned by Delaware residents and Delaware income earned by Maryland residents. In contrast, the unshaded quadrants represent in-state income, comprised of Maryland income earned by Maryland residents and Delaware income earned by Delaware residents.

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4. Delaware, employing a tax regime identical to Maryland's, would impose a Special Non-Resident Tax (SNRT) of 1.25% on taxpayers, like the Wynnes, who reside in Maryland but earn income in Delaware. Maryland would not credit the Delaware SNRT against its own 3.2% residence-based "county" tax. The Delaware source-based SNRT tax (or "county tax") plus the Maryland residence-based "county" tax yields a total, source-and-residence tax rate of 4.45%.

Maryland fails the internal consistency test regardless of the county analyzed.[5] Also, Maryland fails the test regardless of whether we consider the state's tax system in its entirety—by examining both the "state" and the "county" tax together—or if we consider the "county" tax separately.[6] This is so because the Maryland "county" tax rate for interstate income is 1.25% higher than its "county" tax rate for purely in-state income.[7] Because "a law [is] discriminatory if it taxes a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State," *Fulton Corp.* v. *Faulkner*, 516 U.S. 325, 331 (1996), the Maryland Court of Appeals correctly concluded that the Maryland tax regime violates the dormant Commerce Clause. Pet. Br. App. 22.

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5. If, for example, we apply the internal consistency test to the lowest Maryland "county" tax rate of 1.25%, then in-state income is always taxed at 1.25%, whereas interstate income is always taxed at 2.5%. Maryland's "county" tax rate on cross-border income is always 1.25% higher than the "county" tax rate on domestic income.

6. Although the Maryland "state" tax passes the internal consistency test because it credits the taxes of other states, the "state" tax does not fix the internal inconsistency in the "county" tax.

7. As a theoretical matter, we could attribute this difference in tax rates to any of three features of Maryland's tax regime. We could attribute it to: (1) Maryland imposing a tax that is too low on its residents' in-state income, (2) Maryland charging a tax that is too high on residents' out-of-state income (for example, because it fails to credit other states' source taxes taxes), or (3) Maryland charging a tax that is too high on nonresidents' Maryland-source income. As we discuss later, the indeterminacy of the origin of Maryland's restraint on interstate commerce leads to multiple possible ways that Maryland could cure its constitutional violation.

The United States objects that the court below found that Maryland violated internal consistency only because the Maryland court improperly considered Maryland's 1.25% tax on nonresidents (the SNRT). U.S. Br. 24. The United States argues that "Respondents are not subject to that tax, have not challenged it, and suffer no injury from it." U.S. Br. 24. This argument misses the point that the dormant Commerce Clause protects interstate commerce, not people. Moreover, the leading treatise on state taxation explains that "the internal consistency test does not require that taxpayers demonstrate that they have actually suffered injury from the challenged tax, but only that the hypothetical application of the challenged tax by other states would subject them to a more onerous tax burden than that shouldered by taxpayers engaged in intrastate commerce." J. Hellerstein et al., *State Taxation*, ¶ 4.16[1][b] (3d ed. 2014). Finally, as shown below, the SNRT in fact harms Respondents because, in addition to discouraging nonresidents from conducting business in Maryland, the SNRT simultaneously discourages Maryland residents, including the Wynnes, from conducting business outside Maryland. *Fulton Corp.*, 516 U.S. 325 (1996) (holding that a state's intangibles tax violated the dormant Commerce Clause because it discouraged residents from investing in out-of-state companies).

C. Economic Analysis Confirms That Maryland's Tax Regime Prefers In-State To Interstate Commerce

Economic analysis shows that Maryland violates the dormant Commerce Clause because the Maryland "county" tax distorts interstate competition. Specifically, the Maryland "county" tax encourages Maryland residents to earn income in Maryland rather than in other

states, and it simultaneously also encourages nonresidents to earn income outside Maryland, rather than within Maryland. Moreover, we show that applying the internal consistency test to state taxes generates the same results as does economic analysis. Because economic analysis and the internal consistency test produce the same result, the internal consistency test is a good heuristic for evaluating whether a state's tax system violates the dormant Commerce Clause.

Whereas states apply corporate taxes using formula apportionment, states apply individual income taxes on a source and residence basis. Evaluating the impact of state individual income taxes on interstate commerce requires consideration of both source and residence taxes because states may discourage interstate commerce through their source taxes, their residence taxes, or a combination of both taxes. Thus, although Petitioner urges the Court to ignore Maryland's tax treatment of inbound commerce (Pet. Br. 34), determining whether a tax system is neutral between in-state and interstate commerce requires (as described further below) comparing how a state taxes its residents' purely in-state income with how it taxes *both outbound and inbound* economic activities.

Each state can tax three kinds of income:

(1) domestic income, which is in-state income earned by residents,

(2) outbound income, which is out-of-state income earned by residents, and

(3) inbound income, which is in-state income earned by nonresidents.

States generally lack jurisdiction under the Due Process Clause to tax the income that nonresidents earn in other states. To avoid distorting interstate competition between residents of different states, a taxing state has the freedom to set the tax rates on two of those three kinds of income, but having set the first two rates, the third rate is algebraically determined by the first two.

The economic analysis is straight-forward. The share of income that a taxpayer retains after paying tax is called a *retention rate. Figure 3* provides, for each kind of income taxable by Maryland, retention rates for Maryland and non-Maryland (proxied by Delaware) taxpayers after paying Maryland tax. Thus, *Figure 3* provides the *share of earnings retained after-Maryland-tax.*

Figure 3.
Retention Rates on Income Taxable by Maryland

	Maryland Resident	Delaware Resident
Activity in Delaware	*Outbound Income* $1\text{-}T_o$	1
Activity in Maryland	*Domestic Income* $1\text{-}T_d$	*Inbound Income* $1\text{-}T_i$

The retention rate for a Maryland resident on an investment in Maryland is $1\text{-}T_d$, where T_d is Maryland's tax on its residents' in-state income (i.e., Maryland's domestic tax). Likewise, the retention rate for a Maryland resident on an investment in Delaware is $1\text{-}T_o$, where T_o is Maryland's tax on residents' out-of-state income (i.e., Maryland's outbound tax).

The retention rate for a Delaware resident an investment in Maryland is $1\text{-}T_i$, where T_i is Maryland's tax on nonresidents' Maryland-source income (i.e., Maryland's inbound tax). Since Maryland does not tax nonresidents' out-of-state income, a Delaware resident's after-Maryland-tax retention rate on an investment in Maryland equals 1.

Because investors allocate capital across investments in different taxing jurisdictions based upon *relative retention ratios* (i.e., comparisons of retention ratios),[8]

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8. In an environment without taxes, the major result of capital asset pricing models (CAPM) is that all investors end up holding the full universe of available risky assets in the same proportion as those assets are available in the market. Investors might vary the amount of riskless debt and risky assets they hold, and of course the total amount invested in risky assets will differ depending upon the size of one's investment portfolio and attitude towards risk, but everyone will hold the same portfolio of risky assets, differing only in the size of the portfolio, but not in the relative portion of the portfolio (of risky assets) invested in each asset. The risky portfolio of assets held by each taxpayer is called the market portfolio because it is composed of a pro-rata portion of all available (risky) assets.

The after-tax capital asset pricing model (after-tax CAPM) describes how taxes affect the manner in which investors allocate their investment capital across assets in an environment with differentially taxed assets and taxpayers. The main insight from after-tax CAPM is that the intensity of an investor's demand for an asset is determined not by a simple comparison of how an investor is taxed on that asset relative to how other investors are taxed on that same asset. Instead, the intensity of an investor's demand for an asset is determined by how she is taxed on that asset relative to how she is taxed on the market portfolio as compared to how other investors are taxed on that asset relative to how they are

we need to calculate the retention ratios of Maryland and Delaware residents on investments in Maryland. A Maryland resident's *retention ratio* is the share of income remaining when she invests in Maryland relative to what remains when she invests outside Maryland (in Delaware). Thus, a Maryland resident's retention ratio on an investment in Maryland is $(1-T_d)/(1-T_o)$. In contrast, a Delaware resident's retention ratio is the share of income she retains when she invests in Maryland relative to what she retains when she invests in Delaware. Thus a Delaware resident's retention ratio on an investment in Maryland is $(1-T_i)/1$, or $1-T_i$.

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taxed on the market portfolio. The central result that emerges from after-tax CAPM is that an investor will tend to invest more intensively in an asset when she is taxed lightly on an asset relative to how the same investor is taxed on the market portfolio as compared to how other investors are taxed on the asset relative to how they are taxed on the market portfolio. The converse also holds, so an investor will shy away from an asset that bears higher tax relative to the market portfolio for the investor compared to other investors' relative tax for that asset. See Michael Brennan, *Taxes, Market Valuation and Corporate Financial Policy*, 23 Nat'l Tax J. 417 (1970); Roger H. Gordon & David F. Bradford, *Taxation and the Stock Market Valuation of Capital Gains and Dividends*, 14 J. Pub. Econ. 109 (1980).

In order for taxes not to distort interstate commerce, the retention ratios across Maryland and Delaware must be the same for residents of Maryland and residents of Delaware.[9] This requirement can be written as:

$$\frac{1 - T_d}{1 - T_o} = 1 - T_i \qquad (1)$$

Equation 1 describes the condition for income taxes not to distort interstate competition in terms of *retention rates*, which are the share of pre-tax income taxpayers retain after paying Maryland tax. That presentation highlights the mechanism—individual investment choice—whereby tax affects interstate competition. It is also possible to describe the non-distortion condition in terms of *tax rates*, thereby providing states with straightforward guidelines for avoiding distorting interstate competition. After a few simple arithmetic operations, *Equation 1* can be rewritten as:

$$T_d = T_o + T_i - (T_o \times T_i). \qquad (2)$$

That is, the tax rate applied to the domestic income of residents must equal the sum of the tax rates paid by

9. How taxation affects competition between residents of different states depends upon relative retention ratios. If the parties' ratios are the same (even though their tax rates are different), then taxation will not affect where either party invests. If, however, their ratios are different, then taxation will distort competition. Ruth Mason & Michael S. Knoll, *What is Tax Discrimination?*, 121 Yale L. J. 1014, 1060-74 (2012).

residents on out-of-state income and by nonresidents on domestic income less the product of those two rates.[10] If a state's tax rates do not satisfy *Equation 2*, its tax system distorts interstate competition.[11] Notice that this equation does not specify any of the rates; rather it specifies the relationship that the rates must maintain with respect to each other. A state may set its tax rates as high or low as it wants. The dormant Commerce Clause, however, prevents a state from setting its tax on domestic income independently from its tax on interstate (inbound and outbound) income.

In addition to describing this result mathematically, in academic work *amici* describe the result more intuitively as requiring that all taxes be assessed on either a *uniform source* or a *uniform residence* basis.[12] A source tax is uniform if it applies at the same rate and on the same base[13] to both residents' and nonresidents' income from the state. A residence tax is uniform if it applies at the same rate and on the same base to residents' in-state and out-

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10. Expressed slightly differently, the tax rate Maryland applies to its residents' Maryland-source income must be the same as if Maryland first applied the rate applicable to residents' out-of-state income and then applied to the remaining income the rate applicable to nonresidents' Maryland-source income.

11. Ruth Mason & Michael S. Knoll, *Waiting for Perseus*, 67 Tax L. Rev. 375, 436-41 (2014) (providing an algebraic derivation of non-distortion conditions).

12. Mason & Knoll, *What is Tax Discrimination?*, *supra*, at 1060-74 (describing uniformity requirements for taxes not to distort competition).

13. "Tax base" refers to the rules for calculating taxable income.

of-state income. And if a state taxes on both a source and residence basis, it must apply both source and residence taxes to its residents' in-state income.

Courts interpreting the dormant Commerce Clause need not engage in the kind of economic analysis we presented here. Instead, the principle that underlies the dormant Commerce Clause—that states should not distort competition between their residents and residents of other states—generates simple rules of thumb. One rule of thumb, represented by *Equation 1*, is that a state must set tax rates so that retention ratios for residents and nonresidents are equal across jurisdictions. A second rule of thumb, represented by *Equation 2*, is that the tax rate on residents' in-state income must equal the combined tax rate on the in-state income of nonresidents and on the out-of-state income of residents.[14] A third rule of thumb is that state taxes must be uniform.

Still another rule of thumb is the Court's internal consistency test. Taxes that fail the kind of economic analysis we just conducted also will fail the internal consistency test. This equivalence arises because the hypothetical harmonization performed under the internal consistency test has the effect of applying to residents that earn out-of-state income and to nonresidents that earn in-state income both the state's treatment of nonresidents'

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14. The first two rules of thumb, retention ratios and tax rates, apply when the only issue in dispute is tax rates, not tax bases. The uniformity rule and the internal consistency test apply to cases involving base or rate challenges, or both. All four rules of thumb require adjustment when the residence state provides a credit for foreign taxes. See, e.g., Mason & Knoll, *What is Tax Discrimination?*, *supra*, at 1074.

in-state income and the state's treatment of residents' out-of-state income. The internal consistency test thus calculates the combined tax rate from assessing both of those taxes and then compares the combined tax to the rate the state imposes on residents' domestic income. If the rates are the same, then there is no violation. If the rates are different, then taxes distort competition.[15] Thus, the internal consistency test asks the same question as does economics in determining whether a state's tax system distorts competition between residents of different states.

Regardless of whether we frame the inquiry for identifying tax systems that discourage interstate commerce algebraically using formulas, intuitively using uniformity rules, or schematically using the internal consistency test, the result is the same: Maryland's "county" tax discourages interstate commerce. Maryland taxes domestic income earned by Maryland residents at a lower rate (3.2%) than it taxes cross-border income

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15. Thus, not only in substance, but in form as well the internal consistency test is equivalent to the tax rate rule as described in *Equation 2*. The left side of *Equation 2*, the tax rate on domestic residents' domestic income, is the same value as in the unshaded (i.e., in-state income) quadrants of *Figure 2*. The right side of *Equation 2*, the total tax rate from applying the state's taxes on inbound and outbound commerce, is the same as the values in the shaded (i.e., interstate income) quadrants of *Figure 2*. Because the internal consistency test asks whether the tax rates in all four quadrants are equal, it is essentially asking whether *Equation 2* holds. The internal consistency test is also equivalent to the rule of thumb that retention ratios should be equal across residents of different states because that rule, which was mathematically expressed in *Equation 1*, was the source from which *Equation 2* was derived. Finally, non-uniform tax laws fail the internal consistency test because a system with non-uniform laws violates *Equation 2*.

(4.45%, comprised of the 3.2% outbound tax plus the 1.25% inbound tax).[16]

Maryland's higher taxes on interstate income than domestic income generate distortions that affect both residents and nonresidents. Specifically, Maryland discourages residents from engaging in out-of-state commerce and, at the same time, it discourages nonresidents from engaging in commerce in Maryland (including raising capital from Maryland residents). These distortions stem from Maryland alone; they will persist even if no other state imposes a tax.[17]

D. The Internal Consistency Test Is An Appropriate and Helpful Heuristic for Revealing Whether a State's Tax System Violates the Dormant Commerce Clause

Petitioner, the United States, and other *amici* argue that this Court should not apply the internal consistency test because it is clear that under the Due Process Clause Maryland has the power to tax the Wynnes' worldwide income and hence, in their view, there is no issue of fair apportionment. Pet. Br. 37, U.S. Br. 20, Multistate Tax Comm'n Br. 7. But possession by a state of jurisdiction to tax a person under the Due Process Clause does not

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16. Because Maryland does not appear to allow for the purpose of calculating "county" taxable income a deduction for taxes paid to the source state, the tax on cross-border income is 4.45%, not 4.41%.

17. For more on the two-directional distortion caused by non-uniform taxation, see Mason & Knoll, *What is Tax Discrimination?*, *supra*, at 1051-71.

immunize the state from the requirement that it exercise that jurisdiction consistently with other constitutional provisions, including the dormant Commerce Clause.

Both the fair apportionment and nondiscrimination requirements of the dormant Commerce Clause aim to ensure that a state does not discourage interstate commerce relative to in-state commerce. We take no position on whether Maryland violates the fair apportionment prong or the nondiscrimination prong of the *Complete Auto* test. *Complete Auto. Transit, Inc. v. Brady*, 430 U.S. 274 (1977).[18] Rather, we conclude that Maryland violates the dormant Commerce Clause by discouraging interstate commerce relative to in-state commerce. Because the internal consistency test provides the same result as economic analysis in evaluating whether a state tax discourages interstate commerce compared to in-state commerce (which is the central issue in dormant Commerce Clause cases), the test is useful in

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18. We regard failure to apportion taxes fairly to be a subset of tax discrimination as we define it in our academic work. See Mason & Knoll, *What is Tax Discrimination?*, *supra*, at 1060-72. Cf. Alvin C. Warren, Jr., *Income Tax Discrimination Against International Commerce*, 54 Tax L. Rev. 131, 154 (2001) ("[a]lthough not explicitly framed as a nondiscrimination requirement, the [tax] treaty requirement of either a credit or exemption could thus be considered such a requirement"); Michael J. Graetz & Alvin C. Warren, Jr., *Income Tax Discrimination and the Political and Economic Integration of Europe*, 115 Yale L. J. 1186, 1240-1 (2006) ("the Supreme Court has invalidated state tax laws favoring in-state products, producers, and production," but that last kind of case is rare because "the U.S. states' use of formulary apportionment. . . reduces the role of residence taxation because the allocation factors generally relate to source or consumption").

both apportionment and discrimination cases. Indeed, the Court has used internal consistency to evaluate both discrimination and apportionment cases. See, *e.g.*, *Armco, Inc.* v. *Hardesty*, 467 U.S. 638 (1984) (applying internal consistency test in a discrimination case).

In arguing against applying dormant Commerce Clause analysis, including the internal consistency test, to individual income taxation of resident taxpayers, the United States notes that corporate taxes operate on "different principles" from individual income taxes. U.S. Br. 29-30. Nevertheless, the relevant question under the dormant Commerce Clause is the same as applied to individual or corporate taxes, namely, does the state discourage interstate commerce compared to in-state commerce? We see no reason why the Court should not continue to apply the logical rigor and clarity of the internal consistency test to income tax cases.

Petitioner argues that it "make[s] little sense" to apply the internal consistency test to individual income taxes. Pet. Br. 38. Accordingly, we list some of the virtues of using the internal consistency test to evaluate whether individual income taxes discourage cross-border commerce.[19]

First, the dormant Commerce Clause operates as a restraint on state taxation of individuals as well as corporations, and therefore, the same standards should

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19. This analysis draws on our academic work. See Ruth Mason, *Made in America for European Tax: The Internal Consistency Test*, 49 B.C. L. Rev. 1277, 1284-1300, 1309-1319 (2008); Georg Kofler & Ruth Mason, *Double Taxation: A European "Switch in Time"?*, 14 Colum. J. Eur. L. 63, 83-94 (2007).

apply to both. The failure to apply the internal consistency test (or one of the equivalent tests above) to individual taxes would create a large gap in the dormant Commerce Clause and provide states with a roadmap for restricting interstate commerce and dividing up the national market into a series of state markets. If the Court upholds Maryland's "county" tax, what would prevent Maryland from relabeling its "state" tax a "county" tax and completely eliminating credits for other states' taxes? In that case, under hypothetical harmonization, the Wynnes and their Delaware counterparts would pay tax at 7.95% on in-state income and at 15.9% on cross-border income. Such a tax would surely discourage interstate commerce in favor of in-state commerce.

Second, the internal consistency test makes it easier for courts to analyze state taxes under the dormant Commerce Clause because it allows courts to evaluate a single state's tax regime on its own terms, without the need to consider any other state's taxes. Because a court considers only one state's law under the internal consistency test, a question never arises as to *which state* generated the interstate tax disadvantage. As this Court has said, the constitutionality of one state's law should not "depend on the shifting complexities of the tax laws of 49 other States." *Armco, Inc.*, 467 U.S. 638, 644-45 (1984).

Third, the internal consistency test helps avoid judicial error. As long as they do not discriminate, states retain autonomy to set their tax rates. As a result, in the real world, adoption by other states of higher or lower tax rates than that of the challenged state may lead to false positives or false negatives, respectively, when courts attempt to discern discrimination by comparing the amount of tax

paid on interstate commerce to the amount of tax paid on purely in-state commerce. Because tax rates vary, the payment of higher, lower, or equal taxes on cross-border and in-state commerce does not dispose of the discrimination question.

Fourth, the internal consistency test helps courts distinguish tax discrimination from nondiscriminatory cases of double taxation. This Court has held that nondiscriminatory instances of double taxation, such as those arising from disparities in states' income tax bases, do not violate the dormant Commerce Clause. See, e.g., *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 279 (1978). Because the interaction of disparate, but nondiscriminatory, tax regimes may result in nondiscriminatory double or "overlapping" taxation, the absence or presence of unrelieved double taxation cannot serve as a reliable guide to whether a state's tax regime is constitutionally infirm.[20] *Moorman Mfg. Co.*, 437 U.S. at 268 (approving Iowa's single-factor apportionment formula even though

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20. For example, no constitutional principle tells us who ought to be taxable on alimony, the payer or recipient. States may adopt nondiscriminatory, albeit disparate, tax policies for taxing alimony. Imagine State A taxes alimony to the recipient, and offers a deduction to the payer, while State B denies a deduction to the payer, but excludes the alimony from the income of the recipient. These regimes are different, but they both have the effect of taxing the alimony only once between the payer and the recipient, and neither discriminates. Nevertheless, a disadvantage arises when a State B resident pays alimony to a State A recipient because the A resident must include the alimony, but the B resident gets no deduction. Conversely, a double benefit would accrue to a payment from State A to State B. These advantages and disadvantages disappear under the internal consistency test's harmony assumption, which enables a court to attribute the interstate differences to disparity, not discrimination.

it could result in "some overlap" with Illinois' three-factor formula). The internal consistency test eliminates disparities in states' tax bases by hypothetically assuming that all states use the challenged state's tax rules. As a result, any double taxation that remains after application of the harmony assumption by definition cannot arise from tax base disparities, and therefore it must originate in the challenged state's tax law.

Fifth, Petitioner concedes that "[a] state tax based on residency might be subject to internal consistency analysis if the state applied the tax so that it had an impact on taxpayers who actually lived in other states." Pet. Br. 39, n.15. While Petitioner sees no such impact stemming from the challenged Maryland tax regime, the internal consistency test allows us to quickly understand the impact of a state's tax regime upon both residents and nonresidents. The two shaded regions of *Figure 2* show both the impact of the Maryland regime on Maryland residents with out-of-state income (like the Wynnes), the impact of the Maryland regime on nonresidents with Maryland income. The internal consistency test reveals what Petitioner misses: the Maryland tax regime disadvantages both outbound and inbound economic activities relative to the purely domestic activities of Maryland residents.

For these reasons, the internal consistency test represents a useful heuristic to isolate the impact of Maryland's tax law on interstate commerce.[21] That

21. See Walter Hellerstein, *Is "Internal Consistency" Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation*, 87 Mich. L. Rev. 138, 178 (1988) (arguing

Maryland's tax regime fails the internal consistency test shows that Maryland overreaches. *Jefferson Lines*, Inc., 514 U.S. at 169 ("A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction"). Economic analysis confirms that Maryland's tax regime distorts competition between residents and nonresidents for investments within and without Maryland.

E. Tax Regimes That Discriminate Against Interstate Commerce May Contain Elements That Appear To Be Facially Neutral When Viewed In Isolation

The internal consistency test shows that whereas Maryland taxes residents' domestic income once, it taxes interstate income both coming and going. A state taxes natural persons on three kinds of income: domestic, outbound, and inbound. To get an accurate view of how a state taxes interstate commerce requires comparing how the state taxes domestic income to how it taxes both inbound and outbound income. In contrast, Petitioner's disaggregated view of the Maryland tax regime, under which courts compare a state's domestic tax to *only one of* its inbound tax or its outbound tax, allows Maryland to impede interstate commerce with impunity.

Petitioner argues that the Maryland tax does not violate the dormant Commerce Clause because it is

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that internal consistency can be seen as a "proxy for the fair apportionment criterion"). Id. at 178-88 (arguing that cases struck down for failure of internal consistence instead could have been struck down on fair apportionment grounds). Source and residence rules are the individual-income-tax analog to apportionment formulas in unitary business taxes.

facially neutral; Maryland taxes residents' in-state and out-of-state income at the same "county" rate, namely 3.2%. Pet. Br. 35-36. But that neutrality holds only when we isolate Maryland's tax on outbound transactions and compare it to Maryland's tax on domestic transactions. As the internal consistency test vividly demonstrates, this so-called neutrality depends on ignoring Maryland's tax on inbound transactions.

Examining state taxes on just two out of the three kinds of income produces misleading results. For example, in a recent case, *Comptroller* v. *Frey*, 29 A.3d. 475 (Md. 2011), *cert. denied* 132 S.Ct. 1796 (2012), the Maryland Court of Appeals considered whether Maryland's inbound tax (the SNRT) discriminated against interstate commerce. Although the Maryland Court of Appeals concluded that the inbound tax was facially discriminatory because it applied only to nonresidents, the Maryland court nevertheless held that the inbound tax did not violate the dormant Commerce Clause because it was no higher than Maryland's domestic tax.[22]

Thus, in *Frey*, at the urging of the Maryland Comptroller, the Maryland Court of Appeals considered whether Maryland discriminated against *only inbound* commerce. Now, just five years later in *Wynne*, Petitioner asks the Supreme Court to evaluate the question of

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22. *Frey* involved a Delaware resident who was a partner in a limited liability partnership that earned some of its income in Maryland. The Maryland-source income was subject to both the "state" and "county" portions of Maryland's income tax on nonresidents. The Court of Appeals concluded that the "county" tax on nonresidents, the SNRT, "is a facially discriminatory tax." *Frey*, 29 A.3d. at 497.

whether Maryland discriminates against *only outbound* commerce.

Combining *Frey* with *Wynne* shows the problem. In *Frey*, Petitioner succeeded in urging the Maryland Court of Appeals to compare Maryland's 1.25% tax on inbound income with its 3.2% tax on domestic income. *Frey*, 29 A.3d at 496, 505. And now, in *Wynne*, Petitioner asks the Supreme Court to compare Maryland's 3.2% tax on outbound income with the *same* 3.2% tax on domestic income. By double-counting the domestic tax, Petitioner was able to construct: (1) in *Frey* a facially preferential-to-outsiders comparison of domestic and inbound taxes (3.2% versus 1.25%) and (2) in *Wynne* a facially neutral comparison of domestic and outbound taxes (3.2% versus 3.2%).[23]

Double-counting the domestic tax obscures that whereas Maryland taxes residents' domestic income once, it taxes interstate commerce coming and going.[24] The combined Maryland taxes on interstate commerce (i.e., the inbound tax plus the outbound tax) sum to 4.45%,

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23. Our analysis uses the highest "county" tax rate of 3.2%, but the actual "county" rate depends on the taxpayer's county of residence and ranges from 1.25% to 3.2%. The "county" tax rate on nonresidents (SNRT) is set equal to the lowest "county" rate, which is 1.25%. The analysis here holds, no matter which "county" rate we consider.

24. To avoid discouraging interstate commerce, Maryland could, for example, impose *both* taxes—the residence tax *and* the source tax—on residents' Maryland income. In that case, Maryland would have uniform taxes—a uniform source tax of 1.25% and a uniform residence tax of 3.2%. But there are other alternatives for Maryland to cure its violation, as we discuss below.

thus exceeding the Maryland tax on residents' domestic income of 3.2%. If all states adopted similar regimes, interstate commerce would always face more tax than domestic commerce.

Understanding the economic impact of a state's tax on interstate commerce requires analysis of how the state taxes *both inbound and outbound* commerce. Courts must compare a state's treatment of inbound and outbound commerce to the state's treatment of purely domestic commerce. Isolating and comparing the tax on only two out of three types of income provides a partial analysis that may obscure discrimination, whereas analyzing all relevant parts of a state's tax regime comports with the underlying economics as well as the Court's dormant Commerce Clause precedent. The Court regularly looks to disparate parts of a state's tax code to evaluate so-called compensatory tax schemes, under which a "facially discriminatory tax survives strict scrutiny if it is the 'rough equivalent of an identifiable and 'substantially similar' tax on intrastate commerce.'" *Frey*, 29 A.3d at 494 (quoting *Or. Waste Sys.* v. *Dep't of Env't Quality*, 511 U.S. 93, 103 (1994)). This case involves a facially neutral tax that has a discriminatory impact when seen in light of a substantially similar tax on inbound commerce.

Failure to adopt a comprehensive view of a state's tax regime—by considering how the state taxes all of domestic, inbound, and outbound commerce—raises the risk that states will eviscerate the protection that the dormant Commerce Clause provides for interstate commerce by embedding discriminatory tax provisions in disparate parts of their tax regimes. Whether used as heuristics antecedent to economic analysis or as standards

in and of themselves, the rules of thumb described above, including the internal consistency test, prevent disaggregation of the state tax regime into inbound-only and outbound-only elements. As a result, they prevent the kind of incomplete analysis urged by Petitioner both in the instant case and in *Frey*.

II. Maryland Can Cure Its Commerce Clause Violation In Several Ways, None Of Which Depends On The Taxes Collected By Any Other State

The economic analysis above leads to the conclusion that the Maryland tax regime violates the dormant Commerce Clause because it discourages interstate commerce compared to in-state commerce. Although the Supreme Court should find the Maryland "county" tax unconstitutional, there are several ways for Maryland to cure the infirmity, and Maryland, not the courts, should choose the cure.

Although economic analysis shows that Maryland's tax regime discourages Maryland residents from engaging in commerce outside Maryland while simultaneously discouraging nonresidents from engaging in commerce inside Maryland, economic analysis does not and cannot tell us whether Maryland discriminates on either an outbound basis or an inbound basis. Economic analysis (and the internal consistency test) tell us that a state tax regime that does not meet the equivalence in *Equation 2* distorts competition between residents and nonresidents. However, economic analysis does not specify which term in that equation, that is, which tax rate, should change to make the two sides of the equation balance. For example, we cannot conclusively attribute the distortion caused by

Maryland's tax regime exclusively to its outbound taxation in the form of its failure to credit other states' taxes; nor can we conclusively trace the distortion exclusively to Maryland's inbound taxation in the form of the SNRT.

If the Supreme Court affirms the decision of the Maryland Court of Appeals, then Maryland has several options. It can:

(1) raise its domestic tax, T_d,

(2) lower its outbound tax, T_o, including by crediting other states' taxes against its "county" tax or by exempting residents' income earned in other states,

(3) lower its tax on inbound activities, T_i, or

(4) any combination of (1) through (3) that satisfies the tax rate rule given in *Equation 2* or equivalently is internally consistent.

Although crediting other states' taxes generally will cure a state's internal inconsistence,[25] because Maryland

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25. J. Hellerstein et al., *State Taxation*, *supra*, ¶ 4.16[1][b] (approving the lower court's decision in *Wynne*). A common approach would be for Maryland to credit other states' taxes up to the amount of its own tax on outbound investments. Cf. Warren, *supra*, at 153 (describing the commitment in tax treaties to either a foreign tax credit or exemption as aiming to "reduce impediments to international commerce"). However, Maryland could provide a smaller credit and still satisfy internal consistency. For example, Maryland could increase its foreign tax credit by the amount of the SNRT of 1.25%. By increasing the tax credit from 4.75% to 6%, Maryland effectively makes the creditable portion of its tax

can cure its Commerce Clause violation in a number of ways, and the Constitution provides no guidance for which way is best, discretion lies with Maryland.[26] The Supreme Court need not, and should not, choose a particular option for Maryland. Rather, it is up to Maryland to decide how to cure its violation.

Indeed, upon a motion for reconsideration, the Maryland Court of Appeals clarified that,

> A state may avoid discrimination against interstate commerce by providing a tax credit, or some other method of apportionment, to avoid discriminating against interstate commerce in violation of the dormant Commerce Clause. The Comptroller interprets a footnote in our earlier opinion to hold that a state must provide

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system a 6% worldwide tax with a full credit coupled with a 6% tax on Maryland-source income of nonresidents. That leaves the rest of the Maryland tax as a uniform, 1.95% residence tax without a credit on Maryland residents' domestic and out-of-state income. For a discussion of the requirements for state taxes not to distort interstate commerce when the taxing state is offering a credit for taxes paid to other states (which differ from those when the state is not offering a credit), see Mason & Knoll, *What is Tax Discrimination?*, *supra*, at 1063-64, 1072-74.

26. That is, the Constitution gives no answer to the question whether (for Howard County's 3.2% tax rate) Maryland should, for example: (1) increase *Domestic Quadrant* tax to 3.2 + 1.25 – (3.2% x 1.25%) = 4.41%, (2) reduce the *Outbound Quadrant* tax either by eliminating that tax or by allowing a full credit against other states' taxes to reduce Maryland's 3.2% tax on outbound activities, or (3) eliminate the 1.25% *Inbound Quadrant* tax. The choice of how to equalize *Equation 2* remains the sovereign choice of Maryland.

> a tax credit. Slip Op. at pp. 28-29 n.26. While the footnote might have been worded more elegantly, it referred primarily to the method used by the Legislature in the Maryland income tax; we did not mean to preclude other methods that might be utilized in other contexts.

Pet. Br. App. 51-52.

Moreover, affirming the lower court's decision does not spontaneously generate a need to resolve which state—Maryland or the state where the Wynnes earned their income—has priority to tax that income. Affirmation that Maryland's individual income tax regime violates the dormant Commerce Clause does not compel full creditability as the sole remedy, and therefore, contrary to Petitioner's suggestion, it does not amount to a requirement that "the Maryland tax must give way in favor of taxes paid to other states." Pet. Br. 31.

Nor would affirming the lower court bar Maryland from taxing its own residents' out-of-state income. Petitioner argues that a requirement for Maryland to credit other state's taxes would mean that Maryland "is effectively barred from taxing its residents' out-of-state income to the extent that another state has already taxed that income." Pet. Br. 13. This would, in Petitioner's terms, create an "all-take-and no-give arrangement" between Maryland and its residents with out-of-state income because those residents would receive government services from Maryland without having to pay tax. Pet. Br. 24. But, consistently with the dormant Commerce Clause, Maryland can tax nonresidents' out-of-state income at whatever rate it chooses. What Maryland cannot do, however, is set that rate independently of its

rates on domestic and inbound commerce. Maryland's tax on interstate commerce can be no higher than its tax on domestic commerce. As a result, raising its tax on outbound commerce may, under certain circumstances, necessitate raising its tax rate on domestic commerce. That may be politically painful, but the alternative currently in force in Maryland is unconstitutional.

As our analysis makes clear, and contrary to Petitioner's suggestions, none of the options available to Maryland to cure its dormant Commerce Clause violation depends in any way on the actions taken by any other state. Pet. Br. 34, 41.

III. Conclusion

The crucial question under the dormant Commerce Clause is whether a state tax policy "establishes an economic barrier against competition" or an "unreasonable clog upon the mobility of commerce." *Moorman Mfg. Co.*, 437 U.S. at 287-88 (Powell, J., dissenting). As the discussion above makes clear:

The Maryland "county" tax discourages interstate commerce in favor of in-state commerce. The tax regime adversely affects both residents with out-of-state income and nonresidents with in-state income. Thus, the Maryland "county" tax violates the dormant Commerce Clause and so the Court should hold.

Economic analysis and the internal consistency test yield the same results for whether a state tax distorts commerce because both methods test for the same rate equivalence. The internal consistency test therefore represents a simple way for the Court to determine

whether or not a state's tax favors in-state commerce over interstate commerce. The test also reduces the risk that parts of a state tax regime, considered in isolation, will appear to pass constitutional muster even though combining the challenged rule with other parts of the state's tax regime reveals systematic discouragement of interstate commerce.

Maryland can cure the constitutional infirmity in its "county" tax in multiple ways. Accordingly, the Court should affirm the decision below and send the case back to Maryland so that the Maryland legislature can decide how to render the tax consistent with the Commerce Clause. The Court need not, and should not, require Maryland to provide a tax credit for taxes paid to other jurisdictions up to the amount of the "county" tax.

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AMICUS CURIAE BRIEF

No. 13-485

IN THE

Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,

Petitioner,

v.

BRIAN WYNNE, ET UX,

Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF THE MARYLAND CHAMBER OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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BRIEF OF THE MARYLAND CHAMBER OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

STATEMENT OF INTEREST

Amicus Curiae Maryland Chamber of Commerce ("the Maryland Chamber") respectfully submits this brief in support of Respondents Brian Wynne *et ux.*, urging this Court to affirm the decision of the Court of Appeals of Maryland.[1] That court appropriately held

[1] No counsel for any party authored this brief in whole or in part and no entity or person, aside from *amicus curiae*, its members, and its counsel, made any monetary contribution toward the preparation or submission of this brief. Counsel of record for all parties have consented to this filing in letters on file with the Clerk's office.

that Maryland's failure to provide full relief against its resident tax for the tax imposed by other states on income earned in those states unduly burdens interstate commerce and thus runs afoul of the dormant Commerce Clause.

The Maryland Chamber, a statewide organization of over 700 businesses of various sizes that employ over 440,000 employees statewide, is devoted to promoting a favorable business climate in Maryland. The organization's mission is to support its members and advance the State of Maryland as a national and global leader in economic growth and job creation. By working with Maryland's executive and legislative branches of government, the Maryland Chamber seeks to make Maryland a better place in which to live, work and do business.

Maryland is truly a small business state. Approximately 98 percent of Maryland employers have fewer than 100 employees. Most of those employers are so-called "pass-through" entities, including S corporations, limited liability corporations, partnerships, and sole proprietorships. And because no point in Maryland is more than 40 miles away from another state, many of those businesses must and do engage in interstate commerce.

The Maryland Chamber's interest in this case is clear. The Maryland personal income tax regime has a direct and adverse impact on those of its members who operate in "pass-through" form and choose to conduct their business across state lines. As our brief will show, the dormant Commerce Clause prohibits a taxing scheme of the type employed by Maryland.

SUMMARY OF ARGUMENT

The dormant Commerce Clause prohibits a state taxing scheme that exposes taxpayers to multiple state taxation on income earned in interstate commerce, thereby placing an undue burden on interstate commerce. U.S. Const., Art. I, § 8, Cl. 3. Maryland's personal income tax regime does just that. Those Maryland residents who are taxed on income earned in interstate commerce are subjected to multiple taxation—a clear undue burden on interstate commerce—because they do not receive full relief from the Maryland resident tax for taxes paid to other states in which their cross-border income is earned. The absence of such relief creates the risk of multiple taxation, something the dormant Commerce Clause prohibits.

Maryland argues that the relationship of individual residents to their state of residence somehow removes all Commerce Clause restraints from the analysis. That is not correct. This Court has never indicated that an individual's residence relieves a state from its obligation to comply with the dormant Commerce Clause. Rather, this Court's jurisprudence clearly demonstrates that the risk of multiple taxation—regardless of on what individual or what entity the risk falls—is forbidden by the dormant Commerce Clause. When the risk of multiple taxation of the same income arises because of conflicting taxation claims made by the state where the taxpayer resides and the state where the income is earned, the dormant Commerce Clause requires that the former must yield to the latter. Such a result is required here. The decision of the Court of Appeals of Maryland should be affirmed.

ARGUMENT

This case is presented as raising the single question whether the dormant Commerce Clause bars a state from taxing its *individual* residents on all of their income without providing full relief against the resident tax for taxes imposed on the same income by other states where the income was earned. As shown more fully below, the answer to that question is clearly "Yes" under this Court's well-settled dormant Commerce Clause doctrine prohibiting a taxing scheme that creates the risk of multiple taxation on income earned in interstate commerce.

A more appropriate question for this Court to address, however, would be whether the dormant Commerce Clause bars a state from taxing all the income earned by a *corporate* resident without providing full relief for taxes imposed on the same income by other states where the income was earned. Again, the answer to that question is "Yes."

In his brief in support of the petition for certiorari in this case, the Solicitor General asserted that "[t]his case does *not* present any question about the dormant Commerce Clause implications of a State directly taxing the income of a domestic corporation." Brief for the United States as Amicus Curiae on Petition for Writ of Certiorari at 16 n.2 (emphasis supplied). As the ensuing discussion demonstrates, however, this case *does* involve direct state taxation of the income earned by a domestic corporation, *i.e.*, the S corporation of which the respondents are shareholders. And the dormant Commerce Clause prohibition on Maryland's power to tax all the income of a domestic corporation without providing full relief for taxes paid to other states is unassailable.

In any event, whether this case is viewed as involving Maryland's taxation of the income earned by a corporate resident or an individual resident, the result should be the same. The well-established dormant Commerce Clause principles protecting interstate commerce from multiple taxation are equally applicable in both situations.

I. THE DORMANT COMMERCE CLAUSE FORBIDS THE MULTIPLE TAXATION CAUSED BY MARYLAND'S TAXING REGIME

A. The Dormant Commerce Clause Forbids the Risk of Multiple Taxation

For more than 75 years, this Court has steadfastly adhered to the doctrine that the dormant Commerce Clause forbids state taxes that expose interstate commerce to a risk of multiple taxation to which intrastate commerce is not exposed. In *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938), the Court first articulated the basic proposition that while interstate commerce must "pay its way," the dormant Commerce Clause protects interstate commerce from "bear[ing] cumulative burdens not imposed on local commerce." *Id.* at 256. Shortly thereafter, in striking down a levy on dormant Commerce Clause grounds, the Court reiterated that fundamental principle: "Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids." *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938). *See also Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939) (condemning a tax under the dormant Commerce Clause because it exposed interstate commerce to "the

risk of a multiple burden to which local commerce is not exposed").

The Court has never wavered from its commitment to this basic tenet of its dormant Commerce Clause jurisprudence that is indispensable to the protection of free trade from burdensome taxes. *See, e.g.*, *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 446 (1979) ("It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause."); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 442 (1980) (recognizing and addressing claims that the dormant Commerce Clause bars tax that "imposes a burden on interstate and foreign commerce by subjecting . . . income to a substantial risk of multiple taxation"); *Exxon Corp. v. Wisconsin Dep't. of Revenue*, 447 U.S. 207, 228 (1980) (recognizing and addressing a claim that the dormant Commerce Clause bars tax that "subjects interstate business to an unfair burden of multiple taxation"); *MeadWestvaco Corp. v. Illinois Dep't. of Revenue*, 553 U.S. 16, 24 (2008) ("The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation.").

B. When the Risk of Multiple Taxation of Interstate Commerce Is Created by Conflicting Claims of the State of Residence and the State of Source, the Dormant Commerce Clause Requires that the Former Must Yield to the Latter

Over the years, this Court has considered a number of cases addressing the risk of multiple taxation that arises because of the conflicting claims of (a) the state

of a taxpayer's residence, seeking to tax 100 percent of a taxpayer's income or property, regardless of its geographical source or location, and (b) the state where the income or property is earned or located, seeking to tax that portion of the income or property with its source or location (hereafter simply "source") in that state.[2] The problem arises because, apart from the dormant Commerce Clause and the interests in free trade that it protects, the claims of both the state of residence and the state of source are legitimate.

This Court has long recognized these basic propositions. Thus, in the context of income taxation on the basis of residence, the Court has observed: "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312–13 (1937). Accordingly, "[a]s to residents [a State] may, and does, exert its taxing power over their income from all sources, whether within or without the State[.]" *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). The rationale for allowing states to tax residents on their income without regard to source is "founded upon the protection afforded to the recipient of the income by the state, in his person, in

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[2] For ease of exposition, we use the term "source" to mean a location, other than the residence of the taxpayer, where a state may assert the power to tax based on its relationship to the income or property in question. In the context of income taxation, the term "source" is normally used to describe the location where income is earned and thus is taxable by a jurisdiction other than the taxpayer's residence; in the context of movable or intangible property taxation, the term "situs" or "business situs" rather than "source" is typically used to describe the location where such property is situated and is thus taxable by a jurisdiction other than the taxpayer's residence.

his right to receive the income, and in his enjoyment of it when received," *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932), as well as his "[e]njoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws." *Cohn*, 300 U.S. at 313.

The states' power to tax on the basis of source is as well recognized as their power to tax on the basis of residence. *Curry v. McCanless*, 307 U.S. 357, 368 (1939) ("[I]ncome may be taxed both by the state where it is earned and by the state of the recipient's domicile. Protection, benefit, and power over the subject matter are not confined to either state."). Because such power derives only from the protection that the states provide to "persons, property, and business transactions *within their borders*," *Shaffer*, 252 U.S. at 57 (emphasis supplied), however, the power to tax at source is necessarily more circumscribed than the power to tax that flows from "[d]omicil itself." *Cohn*, 300 U.S. at 313. Consequently, when states seek to tax nonresident individuals and corporations using source as their sole jurisdictional basis, their power extends only to the nonresidents' "property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources." *Shaffer*, 252 U.S. at 57.

When both the state of residence and the state of source have a legitimate claim to tax income, the state of residence ordinarily yields to the state of source to avoid double taxation. This is true not only as a matter of national and international practice, American Law Institute, Federal Income Tax Project, *International Aspects of United States Income Taxation* 6 (1987) ("[u]nder internationally accepted practice, it is

incumbent on the domiciliary jurisdiction to alleviate . . . double taxation by some reasonable means"), but also as a matter of federal constitutional law when the risk of multiple taxation burdens interstate commerce.

If both the state of residence and the state of source could tax income or property associated with interstate commerce activity, the risk of multiple taxation would be inevitable. Accordingly, this Court, in accord with the widespread understanding that the state of source has the stronger tax claim, has consistently interpreted the dormant Commerce Clause as requiring the state of residence to yield to the state of source, whenever allowing both claims to prevail would result in multiple taxation of interstate commerce.

This Court articulated the underlying principle in *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952). The taxpayer, an Ohio-based corporation, owned boats and barges that it employed for the transportation of oil along the Mississippi and Ohio Rivers. The vessels, though registered in Cincinnati, made only occasional stops in Ohio for repairs. Their main terminals were in other states. Ohio assessed an ad valorem personal property tax on 100 percent of the value of the vessels. The Court, however, had recently sustained the power of a nondomiciliary state to impose a source-based tax on an apportioned share of the value of vessels that operated within that state. *Ott v. Mississippi Valley Barge Line Co.*, 336 U.S. 169 (1949). Ohio contended that *Ott* did not deprive the domiciliary state of the power to tax the entire value of the vessels, a power the domiciliary state thought it possessed under the Court's earlier doctrine. The Court flatly rejected Ohio's contention, holding that the state of residence

had to yield to the state of source to avoid the risk of multiple taxation: "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. Otherwise there would be multiple taxation of interstate operations . . ." *Standard Oil*, 342 U.S. at 384–85 (internal citation omitted).[3]

This Court has faithfully adhered to the view that the dormant Commerce Clause bar against multiple taxation requires that the power of one state to tax all of an interstate enterprise's property or income on a residence basis must yield to the power of other states to tax the same property or income on a source basis. Thus, in *Central R.R. Co. v. Pennsylvania*, 370 U.S. 607 (1962), the Court sustained the power of the domiciliary state to impose a tax on the full value of the taxpayer's rolling stock, but *only* because it had failed to establish that it was subject to an apportioned source-based tax in other states. As the Court observed, "a State casts no forbidden burden upon interstate commerce by subjecting its own corporations, though they be engaged in interstate transport, to nondiscriminatory property taxes." *Id.* at 612. However, the Court squarely reaffirmed the teachings of *Standard Oil*, declaring that "'multiple taxation of interstate operations' . . . offends the Commerce Clause," and that "multiple taxation is possible . . . if there exists some jurisdiction, in addition to the domicile of the taxpayer, which may constitutionally

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[3] Although *Standard Oil* technically raised only a due process issue, the language of the Court's opinion plainly speaks to dormant Commerce Clause concerns. This Court has explicitly incorporated the principle of *Standard Oil* into its dormant Commerce Clause doctrine, as the ensuing discussion establishes.

impose an ad valorem tax." *Id.* (internal citations omitted).

Likewise, in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), the Court, in delineating the dormant Commerce Clause restraints on state taxation of the instrumentalities of interstate commerce, observed that "[i]n order to prevent multiple taxation of interstate commerce, this Court has required that taxes must be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Id.* at 446–47. Then, reiterating the basic principle that governs this case, the Court declared:

> The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full. "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. . . . Otherwise there would be multiple taxation of interstate operations." *Standard Oil Co. v. Peck*, 342 U.S. at 384–385.

Id. at 447.

In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), the Court reaffirmed, in the income tax context, the dormant Commerce Clause doctrine that precludes one state from taxing all of a taxpayer's income on a residence basis when another state has the power to tax an apportioned share of that income on a source basis. In *Mobil*, the question was whether Vermont could tax on a source basis an apportioned share of the dividends that Mobil Oil Corporation, a New York domiciliary, received from its foreign

subsidiaries. One of the arguments advanced by Mobil was that Vermont could not tax an apportioned share of such income because it would expose Mobil to the risk of multiple taxation in light of New York's alleged power as Mobil's commercial domicile to tax the dividends on an unapportioned basis.

This Court rejected the underlying premise of Mobil's argument. The Court first reiterated the basic principle that the dormant Commerce Clause would not tolerate the multiple taxation that would result from imposition of a tax on Mobil's dividends both "by apportionment" on a source basis and "by allocation to a single situs" on a residence basis. As the Court put it, "[t]axation by apportionment and by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained." *Id.* at 444–45. While multiple taxation of the same income was constitutionally unacceptable, the Court was nevertheless willing to "assume, for the present purposes, that the State of commercial domicile has the power to lay *some* tax on the appellant's dividend income." *Id.* at 445 (emphasis supplied). However, when it came to the ultimate question whether the state of residence trumps the state of source in the face of conflicting claims to the same income, the Court reaffirmed the rule that residence must yield to source. Thus, although the state of commercial domicile has the power to tax "some" of the appellant's dividend income, "there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the

accepted method." *Id.* at 445–46. In short, a residence-based tax allocating a taxpayer's entire income to a single state does not prevail over a source-based tax apportioning a taxpayer's income to the states in which it does business.

C. Maryland's Taxing Regime Creates the Risk of Multiple Taxation of Interstate Commerce Because of the Conflicting Claims of the State of Residence and the State of Source

There can be no dispute over the proposition that Maryland's taxing regime creates precisely the risk of multiple taxation identified in the Court's decisions discussed above.[4] Maryland imposes a tax on all the income earned by its residents and on all the income earned in Maryland by nonresidents. It fails to provide full relief against its resident tax, through a credit, apportionment, or exemption, for taxes imposed by other states when the income it taxes is earned in those states and is also taxable there on a source basis. As a consequence, the risk of multiple taxation for residents who cross state lines to engage in economic activity is indisputable. Accordingly, under the settled law reflected in this Court's dormant Commerce Clause doctrine, Maryland, as the state of residence, must yield to the conflicting claims of the state or

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[4] For purposes of dormant Commerce Clause analysis, it makes no difference whether the taxing power in question is exercised by the State of Maryland or by one of its political subdivisions (*e.g.*, a county). It is well settled that any action by a political subdivision of a state is subject to the same restraints that would be imposed on the state itself if the state itself had taken the challenged action in question. *See Frey v. Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011) (county income taxes are part of a single State-imposed income tax scheme).

states of source, in order to avoid the multiple taxation that would otherwise result.[5]

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[5] In addition to violating the established dormant Commerce Clause principles described above, the Maryland statute also constitutes a clear violation of the "internal consistency" doctrine that the Court has articulated under the dormant Commerce Clause. Under this doctrine, a state tax will be struck down if it is not "internally consistent." As originally articulated in *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983), the tax would be internally consistent if its application by every state "would result in no more than all of the unitary business' income being taxed." In other words, there could be no multiple taxation of the same income. As the Court later described the doctrine in *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995):

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with intrastate commerce.

Maryland's tax regime plainly flunks the "internal consistency" test. For example, if every other state imposed an income tax scheme like Maryland's, at an assumed rate of 6% (of which 1% represented the county tax rate), a resident who crossed state lines to engage in economic activity, earning $10,000 in other states as a result of her efforts, would pay a $600 source-based tax to those states and owe a $600 residence-based tax to Maryland, but would receive a credit of only $500 against her residence-based taxes, because Maryland provides no credit against the tax attributed to the county rate. The resident would thus pay a total of $700 in taxes. By contrast, a Maryland resident who confined her economic activity to Maryland and earned $10,000 from such activity would pay a total tax of only $600. The "internal inconsistency" of the Maryland regime is indisputable

II. THE DORMANT COMMERCE CLAUSE BARS MARYLAND FROM TAXING ITS INDIVIDUAL RESIDENTS ON ALL THEIR INCOME WITHOUT PROVIDING FULL RELIEF FROM TAXES IMPOSED ON THE SAME INCOME BY STATES WHERE THE INCOME WAS EARNED.

On the assumption that this case raises only the question whether the dormant Commerce Clause bars a state from taxing its *individual* residents on all of their income earned in interstate commerce without providing full relief from taxes imposed on the same income by the states where the income was earned, the remaining question is whether dormant Commerce Clause principles apply to this case. Indeed, this case could easily be decided if the dormant Commerce Clause simply does not protect individual residents from their own state taxes.

There is no support for such a radically novel approach to Commerce Clause adjudication except a passing comment in *Goldberg v. Sweet*, 488 U.S. 252 (1989), that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Id.* at 266. But *Goldberg* cannot stand for the proposition that the Commerce Clause does not protect residents from their own state taxes. Indeed, the Court's extended treatment of the dormant Commerce Clause issue in *Goldberg* itself would seem to have been unnecessary if resident taxpayers were deprived of Commerce Clause protections from their

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because "imposition of a tax identical to the one in question by every other State" *would* result in multiple taxation and *would* add a "burden to interstate commerce that intrastate commerce would not also bear."

own state taxes, because the challenged tax in that very case–at least in the vast majority of applications–came to rest on in-state residents.

Moreover, even a moment's reflection demonstrates that this Court's dormant Commerce Clause jurisprudence indisputably protects individual residents from their own state taxes in a wide variety of circumstances. Thus, no one would seriously suggest that the dormant Commerce Clause would not protect state residents from their own state taxes that subject income earned from sources in other states to a higher tax rate than income earned from sources within the residence state. A more blatant discrimination against interstate commerce in violation of the "free trade" principles underlying the dormant Commerce Clause is difficult to imagine. Nor would anyone seriously contend that the dormant Commerce Clause does not protect state residents from their own state taxes that impose a higher tax on products produced outside the state than those produced locally. In fact, this Court explicitly recognized this point, thereby repudiating its earlier dictum, when it declared that "[s]tate taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products, they are unconstitutional." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 203 (1994).

With the exception of its ill-considered dictum in *Goldberg*, which it subsequently repudiated in *West Lynn Creamery*, this Court has never suggested that the dormant Commerce Clause provides less protection to individual state residents from state-imposed burdens on interstate commerce than it provides to any other persons (natural or juridical). To the contrary, the Court has routinely entertained

dormant Commerce Clause claims raised by individual residents regarding their own state laws without any mention of a double Commerce Clause standard applied to individual residents as distinguished from other litigants. *See, e.g., Maine v. Taylor*, 477 U.S. 131 (1986) (entertaining Maine resident's dormant Commerce Clause attack on Maine law); *Sporhase v. Nebraska*, 458 U.S. 941 (1982) (entertaining Nebraska residents' dormant Commerce Clause attack on Nebraska law); *cf. Granholm v. Heald*, 544 U.S. 460, 473 (2005) (entertaining dormant Commerce Clause attack by, among others, Michigan residents against Michigan law limiting shipments of out-of-state wine to in-state consumers and noting that Commerce Clause guarantees "citizens of their right to have access to the markets of other States on equal terms"). Indeed, just six years ago this Court considered a dormant Commerce Clause challenge by individual residents to their own state laws in a situation similar to what we have here. In *Dep't. of Revenue v. Davis*, 553 U.S. 328 (2008), the Court considered two Kentucky residents' dormant Commerce Clause challenges to the application of Kentucky's personal income tax. While the Court ultimately rejected the dormant Commerce Clause claim on the merits,[6] there was no suggestion that the dormant Commerce Clause did not protect residents from their own state income taxes, because, of course, it does.

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[6] The Court ruled that a tax exemption that "favors a traditional government function without any differential treatment favoring local entities over similar out-of-state interests" does "not 'discriminate against interstate commerce' for purposes of the dormant Commerce Clause." *Id.* at 343 (citation omitted).

Apart from its errant (and subsequently repudiated) comment in *Goldberg*, there is simply nothing in this Court's dormant Commerce Clause jurisprudence that would ever lead one to conclude that the free trade protection the Commerce Clause provides should be compromised when an individual state resident (as distinguished from some other natural or jural person) bears the multiple burdens that state tax legislation imposes on interstate commerce. Indeed, this Court has made it clear that "the dormant Commerce Clause protects *markets* and *participants in markets*, not taxpayers as such." *General Motors Corp. v. Tracy*, 519 U.S. 278, 300 (1997) (emphasis supplied). For this reason, a taxpayer's status as an individual resident is simply irrelevant to the legitimacy of a Commerce Clause claim, which is directed at burdens imposed on *markets* and on *participants in markets*.

Because the dormant Commerce Clause plainly protects individual residents from their own state personal income taxes, and because Maryland's taxing scheme as applied to its individual residents clearly imposes a burden on interstate commerce that the dormant Commerce Clause forbids by subjecting its residents to multiple taxation on the same income, Maryland's taxing scheme must be held invalid. Maryland may fulfill its constitutional obligation through a full credit against its resident tax for taxes paid to other states, as other states do in the context of state personal income taxation, or through some other mechanism that provides the required relief (*e.g.*, apportionment or exemption).

III. DORMANT COMMERCE CLAUSE RESTRAINTS ON STATE TAXATION OF INCOME EARNED IN INTERSTATE COMMERCE BY DOMESTIC CORPORATIONS ALSO INVALIDATE MARYLAND'S TAXING SCHEME

The income being taxed by Maryland here actually includes income attributed to an individual resident shareholder of an S corporation domiciled in Maryland. The S corporation earned its income not only in Maryland but also in many other states. Its out-of-state income was subject to tax in the states where it was earned.

An S corporation is defined in the Internal Revenue Code as a domestic corporation that meets certain ownership and other technical requirements, includeing a limitation of no more than 100 shareholders, and that elects to be treated as an S corporation. 26 U.S.C. §§ 1361, 1362 (as in effect in 2006 and currently). (All other corporations are referred to as C corporations for federal income tax purposes.)

So far as here pertinent, the consequence of making an S corporation election is that, for federal income tax purposes, the corporate entity is essentially ignored. With some minor exceptions not relevant here, all items of income and expense that the corporation generates in carrying on its business are "passed through" to the shareholders and attributed to them for tax reporting purposes. 26 U.S.C. § 1366. The corporate level tax is thereby eliminated and the net income of the business is taxed to the shareholders as if they had earned it directly. The corporation's specific items of income and expense retain their

character at the shareholder level, "as if such item were realized *directly from the source from which realized by the corporation*, or incurred in the same manner as incurred by the corporation." 26 U.S.C. § 1366(b) (emphasis supplied).

Maryland has adopted the federal tax treatment of S corporations. *See* Md. Code Ann., Tax-General ("Tax-Gen.") §§ 10-101(l), 10-107 , 10-201 *et. seq.*, 10-104(6). It requires individual resident taxpayers to report the full amount of their "federal adjusted gross income" as the starting point for computing their state taxable income. Tax-Gen. § 10-203 . As a result, the entire amount of S corporation income attributed to a resident shareholder for federal income tax purposes is also attributed to the shareholder for Maryland tax purposes. But, as noted, federal adjusted gross income that includes income attributed from an S corporation reflects the character of that income, as if realized directly from the same source. If the S corporation is engaged in interstate commerce, the S corporation income attributed to a resident shareholder will include income earned in interstate commerce. Contrary to the suggestions made here by the Solicitor General and *amicus* Multistate Tax Commission, the income of an S corporation attributed to its shareholders does not change its character and become "personal income" or "investment income" at the shareholder level. Brief for United States as Amicus Curiae Supporting Petitioner at 30 n.6; Brief for Multistate Tax Commission as Amicus Curiae Supporting Petitioner at 10. There is no basis for either such characterization. Rather, the income attributed to the shareholders remains exactly what it is—business income that was earned by their corporation in interstate commerce. Under the

Maryland scheme, the full amount of such income is included in the individual shareholder's tax base.

By contrast, and consistent with fundamental dormant Commerce Clause principles intended to prevent the multiple taxation of income earned in interstate commerce, Maryland affirmatively disavows any attempt to tax the full amount of net income earned by a *corporate resident* doing business both within and without the State. Instead, like other states, Maryland specifically calls for the apportionment of corporate income so that the State will tax only that portion of the net income "derived from or reasonably attributable to" the portion of the corporation's business carried on in Maryland. Tax-Gen. § 10-402. Maryland's apportionment rule complies with the long-standing dormant Commerce Clause requirement, reflected in this Court's distillation of its dormant Commerce Clause doctrine in *Complete Auto Transit v. Brady*, 430 U.S. 274, 287 (1977), that a State may permissibly tax income derived from interstate commerce only to the extent that the income is, *inter alia,* "fairly apportioned" to the taxing state. Neither *Complete Auto Transit* nor any of the Court's other cases interpreting the dormant Commerce Clause sanctions a different analysis for income earned by a corporation merely because it is an S corporation, rather than a C corporation.

Maryland's corporate apportionment statute does not extend to net income earned by a resident S corporation. Nevertheless, as a constitutional matter, Maryland's ability to tax such income is necessarily governed by dormant Commerce Clause principles. Those principles establish that only the amount of net income fairly apportioned to Maryland may

permissibly be taxed by Maryland. That is true whether the corporation earning the income is labeled an S corporation or a C corporation. Without apportionment, Maryland would (and does) tax amounts that reflect value earned outside its borders, thereby producing the risk of multiple taxation on such income that impermissibly burdens interstate commerce.[7]

This case is unusual because, in lieu of a provision calling for apportionment of the income earned by a resident S corporation both within and without the State, Maryland offers the individual resident shareholders of such a corporation what it offers to all other individual resident taxpayers, namely, a credit against its resident tax for taxes paid to other states on income earned in those states. Constitutionally, such a credit could be an effective surrogate for the fair apportionment the dormant Commerce Clause requires here, except for one fact: Maryland offers only a *partial* credit, *i.e.*, a credit only against the "State portion" of its income tax. The "County portion" of the Maryland income tax is not subject to credit for taxes paid to other states.[8]

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[7] While there is no decision of this Court squarely holding that a State may not tax the entire net income of a domiciliary corporation without apportionment, there is also no decision holding that it may. The reasoning of all relevant decisions of this Court consistently points to the conclusion that, whether the taxing state is the domiciliary state or a non-domiciliary state, fair apportionment is required to survive a dormant Commerce Clause challenge to the taxation of net income earned in interstate commerce.

[8] A proper credit for tax paid to another state on the same income is intended to ensure that the total tax paid on such income does not exceed the higher of the two state rates involved. *See Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 191 n.30 (1983).

Maryland's refusal to allow a credit against the County portion of its tax ensures that, in the case of an S corporation doing business in any of the numerous states with a higher tax rate than the Maryland "State rate," resident S corporation shareholders would bear two taxes on the same income: (1) the full tax imposed by the other state on the income earned there, plus (2) a Maryland tax at the County rate on the same interstate income. That additional Maryland tax on the income earned out-of-state produces the very type of multiple taxation prohibited by the dormant Commerce Clause, thereby imposing an undue burden on interstate commerce.[9]

Significantly, when viewed in this light, it becomes clear that Maryland's taxing scheme is also facially discriminatory. Not only does it produce an impermissible double tax in those cases when a Maryland S corporation earns income in a higher-tax state, it also discriminates against shareholders and their corporations seeking to compete in high-tax markets by favoring those who choose to limit their activity to within Maryland's own borders or to other low-tax or no-tax states. Shareholders choosing to have their S corporation engage in activity in a high-tax state will invariably be subjected to multiple taxation. The Maryland scheme hampers free trade in the broadest sense, by placing economic pressure on residents to keep their business activities confined to the local market or certain other markets. That pressure denies them the opportunity to make "tax neutral" decisions

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[9] In 2006, more than half of the states imposed a tax rate on both corporations and individuals higher than Maryland's state tax rate. The same is true today. *See* State Individual Income Tax Rates, 2000-2014, *Tax Foundation*, *available at* http://taxfoundation.org/article/state-individual-income-tax-rates.

as to where to carry on business. *See generally, Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318 (1977)

Put another way, the Maryland taxing scheme unequivocally discourages its residents from engaging in interstate commerce in high-tax markets by placing them at a distinct disadvantage in relation to their local competitors in those markets. Such a taxing scheme produces impermissible discrimination against interstate commerce. Only by allowing a full credit against both the State and County portions of its tax (or by providing equivalent relief through apportionment of the taxpayer's income among the states in which was earned or by exempting income earned in other states) can Maryland alleviate the discrimination in its taxing scheme and thereby afford its residents the "tax neutral" choices required under the dormant Commerce Clause.

* * *

The preceding discussion demonstrates that the dormant Commerce Clause protects individual state residents from their own state personal income taxes when those taxes burden interstate commerce and that the dormant Commerce Clause forbids the multiple tax burden imposed on interstate commerce under Maryland's tax regime. The decision below must therefore be affirmed unless this Court abandons its settled precedent and deprives state residents of the dormant Commerce Clause protection they have long enjoyed.

Adoption of a new rule stripping individual residents of their dormant Commerce Clause protection with respect to their own state personal income taxes would destroy the existing understandings on the

limits of state tax power that have given rise to a commendable framework for avoiding multiple taxation in this area. If these understandings are disavowed, it may not be long before other states join Maryland in refusing to provide their residents with a credit for taxes they pay on income earned in other states, with devastating consequences for the national common market that the dormant Commerce Clause was designed to foster.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals of Maryland should be affirmed.

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AMICUS CURIAE BRIEF

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RECORDS
AND
BRIEFS

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In the
Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
Petitioner,
v.
BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the
Court of Appeals of Maryland

BRIEF OF MULTISTATE TAX COMMISSION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER MARYLAND STATE COMPTROLLER OF THE TREASURY

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BRIEF OF MULTISTATE TAX COMMISSION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER-APPELLANT MARYLAND STATE COMPTROLLER OF THE TREASURY

INTEREST OF THE *AMICUS CURIAE*

Amicus curiae Multistate Tax Commission ("the Commission") respectfully submits this brief in support of the Petitioner-Appellant Maryland State Comptroller of the Treasury urging this Court to reverse the decision of the Maryland Court of Appeals.[1] That decision fundamentally misinterprets this Court's dormant Commerce Clause jurisprudence and would upend vital and long-established principles of residency-based taxation if followed by this Court.

The issue before this Court is whether the Commerce Clause, U.S. Const. art. I, § 8, cl. 3, requires Maryland to reduce its own tax on income realized by resident shareholders of a corporate entity by an amount equal to the taxes paid by those shareholders in other states in which the entity conducted business. Maryland gives its residents only a partial credit against its own income tax for income taxes

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[1] No counsel for any party authored this brief in whole or in part. Only *amicus curiae* Multistate Tax Commission and its member states, through the payment of their membership fees, made any monetary contribution to the preparation or submission of this brief. This brief is filed by the Commission, not on behalf of any particular member state, other than the State of Maryland. Finally, this brief is filed with the consent of the parties.

paid to other states in that situation. MD. CODE ANN., TAX-GEN. § 10-703.[2] The Maryland Court of Appeals has determined that the failure to afford a full credit results in prohibited discrimination against interstate commerce because, assuming other states also assert the authority to tax the income, Maryland residents might be more inclined to invest in business entities that confine their operations to Maryland to avoid the possibility of being "double-taxed" on any portion of their incomes. *Maryland State Comptroller of Treasury v. Wynne*, 64 A.3d 453, 470 (Md. 2013).

The decision of the state of Maryland to tax its own residents on one-hundred percent of their incomes, providing only a partial credit for taxes paid to other states, does not violate the dormant Commerce Clause because the Maryland tax scheme does not discriminate against interstate commerce. Maryland is not taxing an out-of-state business; it is only taxing the income of its own residents for the benefit of residing in Maryland, and properly doing so without regard to the putative geographic source or the means by which that income is earned.

In addition to having the sovereign authority to adopt such a system, Maryland has compelling policy reasons for ensuring that its residents pay for the

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[2] Maryland's taxing system includes both state-level and county-level income taxes. MD. TAX-GEN. § 10-103(a)(1). Maryland allows a credit against taxes paid to other states but does not allow a similar county-level credit for taxes paid to other states. MD. TAX-GEN. § 10-703(a). For purposes of this brief, the Commission analyzes both taxes as state-level impositions. *See Frey v. Comptroller*, 29 A.3d 475 (Md. 2011).

benefits they receive as a consequence of their status, including access to publicly-financed education and a safety net of public assistance and social programs. By the same token, states also have the sovereign authority to impose nondiscriminatory taxes on nonresidents to the extent they derive a portion of their income from businesses or property interests located within those states based on the protections and benefits provided by those states. *Shaffer v. Carter*, 252 U.S. 37, 50 (1920).

The Maryland Court of Appeal's holding that residency-based income taxes must yield to source-based taxes would have far-reaching effects on state and local governments if affirmed by this Court. These governments provide different kinds of services and protections both for their citizens and nonresidents. These services are funded by a system of potentially overlapping taxes that may include residency and source-based taxes levied on or by reference to gross or net income, narrowly or broadly defined, or on some other base. Where each tax is facially neutral and non-discriminatory, there are no constitutional guidelines for determining which tax must yield to the other, and no reason to believe the framers of the Constitution intended to impose any particular taxing system upon the states. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 277-79 (1978).

A decision upholding the Maryland Court of Appeals would involve the state courts in a never-ending task of determining whether particular taxes imposed on an individual as a resident should be reduced or eliminated because another state or local government also has jurisdiction to impose a tax on

the individual as a nonresident. For example, must a state that imposes an annual stock value tax on resident shareholders, measured by reference to retained earnings of their corporate investments, give a credit against that tax for income taxes paid by the corporations to other states? Analyzing the interplay of many potentially conflicting state and local government tax systems to determine whether a credit is mandated would require the courts to make legislative value judgments, and could ultimately undermine our system of federalism by limiting state tax policy choices and revenues. The framers recognized that the power to tax was:

> [T]he highest attribute of sovereignty, the right to raise revenue; in fact, the right to exist; without which no other right can be held or enjoyed. The general power to tax is not denied to the states...

M'Culloch v. State of Maryland, et. al, 17 U.S. 316, 336 (1819).

The Commission was established by the Multistate Tax Compact, which became effective in 1967. *See United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978) (upholding the validity of the Compact). Today, forty-seven states and the District of Columbia participate in the Commission as compact, sovereignty, or associate members.

The purposes of the Compact are to: (1) facilitate proper determination of state and local tax liability of multistate taxpayers, including equitable apportionment of tax bases and settlement of apportion-

ment disputes, (2) promote uniformity or compatibility in significant components of state tax systems, (3) facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of state tax administration, and (4) avoid duplicative taxation. Multistate Tax Compact, Art. I. The Compact was one response by the states to the need for reform in state taxation of interstate commerce. *See, e.g.,* H.R. Rep. No. 89-952, Pt. VI, at 1143 (1965) and Interstate Taxation Act: Hearings on H.R. 11798 and Companion Bills before Special Subcommittee on State Taxation of Interstate Commerce of the House Commission on the Judiciary, 89th Cong., 2d. Sess. (1966) (illustrating the depth and scope of congressional inquiry into the potential for federal preemption of state tax).

The Commission's interest in this case arises from our goal of preserving the states' sovereign authority to determine their own tax policies within federal constitutional and statutory limitations. There may be nothing more fundamental to state sovereignty than preservation of the authority to determine how residents will be taxed for the privileges and benefits of citizenship. Extension of dormant Commerce Clause tests, applied by this Court in other contexts, to a tax imposed by a state on its residents' income from investments is a significant and unnecessary intrusion upon state authority.

SUMMARY OF ARGUMENT

The Commission urges this Court to hold that Maryland's taxing system is a valid and non-

discriminatory exercise of the state's unquestioned power to tax its residents on income derived from whatever source, in order to ensure that all residents pay for the privilege of living within the state's protections. The state is not required to reduce the tax obligations imposed on its residents for the privilege of residing within the state simply because another jurisdiction has the authority to impose a facially neutral, nondiscriminatory tax on a portion of that individual's income based on its origin. The benefits and protections afforded to the Respondents ("the Wynnes" or "the taxpayers") as residents differ from the benefits and protections afforded by other states to them as investors in a business operating in those states. The Maryland Court of Appeals erred in evaluating a tax on residents as if it were a tax on a multistate business, and reached the wrong conclusion as a result of applying the wrong test to the wrong activity.

A decision upholding the Maryland Court of Appeals would have profound and unpredictable effects on state and local governments. A holding that the Commerce Clause requires a state to reduce a facially neutral, non-discriminatory tax imposed on its own residents based on the amount of tax imposed on that individual by another state for activities in that state would disrupt the system of federalism on which our Union is founded. Under this system, individuals may enjoy the privileges and rights of citizenship in their state of residency, as well as the benefits provided to them by other states in which they have property or activities. States, in turn, have extensive jurisdiction and authority with respect to

their own citizens, by virtue of their residency in the state, as well some jurisdiction over nonresidents, who may be present or have property or activities in the state. Under this system, there is potential for some overlapping taxation. This is not a flaw of federalism, but a reflection of it.

ARGUMENT

I. Maryland's Decision to Tax its Residents Upon Their Entire Incomes Without Allowing a Full Credit for Taxes Paid in Other Jurisdictions Does Not Violate The Commerce Clause of the United States Constitution

The Wynnes are residents of Maryland who are subject to tax on their total income without regard to source. MD. CODE ANN., TAX-GEN. §§ 10-101(i), 10-102, 10-203. They do not claim that Maryland's imposition of tax on their total incomes is not fairly related to the considerable benefits and protections provided to them as residents of the state. *See Wynne*, 64 A.3d at 463.

The Maryland Court of Appeals ignored the taxpayers' status as residents and instead applied a four-part test commonly used by this Court in determining whether a tax impermissibly burdens a business operating in multistate commerce. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).[3] *Wynne*, 64 A.3d at 463. The Maryland court

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[3] The test is: (a) does the tax fall upon an activity with a substantial nexus to the taxing state; (b) is it fairly apportioned; (c)

applied this test, designed to determine when states might exceed their authority to tax interstate transactions or multistate business operations, to a residency-based tax. This yielded what was, perhaps, a predictable result: a dormant Commerce Clause violation. Although the decision below nominally turned on the extent of any "credit" which must be allowed for taxes paid to other states, the Maryland court's reasoning could apply to any residency-based tax that was imposed on income that arguably had a foreign source.

As this Court has held on many occasions, the purpose of the dormant Commerce Clause is to prevent states from erecting economic barriers around themselves by favoring in-state economic interests at the expense of out-of-state competitors. *See, e.g., New Energy Co. of Ind. v. Limbach,* 486 U.S. 269, 273–274 (1988); *Fulton Corp. v. Faulkner,* 516 U.S. 325, 330 (1996); *Dep't of Rev. of Kentucky v. Davis,* 553 U.S. 328 (2008). Taxes imposed by a state on its own residents in a neutral manner present little opportunity for application of the Commerce Clause. *See Goldberg v. Sweet,* 488 U.S. 252, 266 (1989)("It is not a purpose of the Commerce Clause to protect state residents from their own state taxes.") There is no evidence in this case that Maryland's facially neutral taxing system was designed to or has the effect of benefiting in-state economic interests at the expense of out-of-state competitors. This omission is fatal to the claim of impermissible discrimination.

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is it non-discriminatory; and (d) is the tax fairly related to benefits and protections afforded by the states? 430 U.S. at 279-80.

A. Maryland is Not Taxing an Interstate Business; It is Imposing a Tax on its Residents

The taxpayers are shareholders in Maxim, Inc., a corporation formed in Maryland (*Pet. for Writ of Cert.* at 3) that has elected under Subchapter S of the Internal Revenue Code ("I.R.C."), along with all its shareholders, to forgo entity-level taxation otherwise imposed on corporations under the federal income tax system. *See* 26 U.S.C. § 1363. Maryland follows the federal election and allows the entity to forego state tax at the entity level. But Maryland also provided a credit to the Wynnes for taxes paid by Maxim where another state did not follow federal tax treatment and instead imposed an entity-level tax. *Br. of Pet.* at 5 n.4.

The crux of the taxpayers' Commerce Clause argument is that Maryland's residency-based tax is actually a tax on Maxim's extra-territorial income: "it is Maxim's income, imputed to the Wynnes by Maxim's S-Corporation's election and Maryland's tax statutes." *Supp. Resp. to the Solicitor General's Brief in Support of Cert.* at 8.

If Maxim's shareholders had not made the Subchapter S election, Maryland would impose separate taxes on Maxim and on the Wynnes. *See* MD. CODE ANN., TAX-GEN. §§ 10-102, 10-101(l), 10-104. In addition to taxing the Wynnes on one-hundred percent of any corporate distributions or dividends received, the state would tax a portion of Maxim's income derived from sources within the state. Nor would the Wynnes be entitled to take a credit against the tax on corporate distributions for taxes the corporation

might have paid to other states. But Maxim is not a taxpayer in Maryland and Maryland has not sought to tax any of its income. This was the conceptual mistake made by the Maryland court: conflating the taxes imposed upon the Wynnes, as residents receiving investment income, with a tax on Maxim itself.

Because of this mistake, the Maryland court determined that it must apply *Complete Auto's* four-part test to the tax on the Wynne's income. The court noted that there was no dispute that the first (substantial nexus) and fourth (fair relationship) prongs were met. The court concluded, however, that the failure to grant a full credit violated the second and third prongs, fair apportionment and non-discrimination.

In determining whether Maryland's tax was "fairly apportioned," the Maryland Court of Appeals applied the "internal consistency" and "external consistency" standard announced in *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983). *Wynne,* 64 A.3d at 467-68. The test for internal consistency is described as follows: "the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." The test for "external consistency" is described as: "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Container,* 463 U.S. at 169.

Neither the internal nor external consistency tests are applicable to Maryland's tax on its residents. As for internal consistency, had the Maryland

Court of Appeals understood that Maxim was not subject to a tax on its earnings, and the only "taxable event" at issue was the Wynnes' residency within the state, it is hard to understand how the court would have reached its conclusion that Maryland's taxing system was internally inconsistent, since the Wynnes can be legal residents of only one state. *See Restatement (Second) of Conflicts*, § 11 (1969).

By the same token, the court's determination that Maryland's tax system is "externally inconsistent," (*Wynne,* 64 A.3d at 467) for failing to give a credit for liabilities incurred in other jurisdictions becomes untenable, unless the court was also prepared to say that a tax credit must be provided for dividends received from taxable C corporations and other sources of investment income.

B. Residency Within a State is Sufficient Justification for Imposing a Tax on Income Received from Whatever Source.

The fundamental authority of sovereigns to tax their citizens on all of their income from whatever source derived has been established in this Court for almost a century in the context of federal taxes, *Cook v. Tait,* 265 U.S. 47, 56 (1924) and state taxes, *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). *See also Curry v. McCanless,* 307 U.S. 357, 368 (1939)("the state of domicile is not deprived, by the taxpayer's activities elsewhere, of its constitutional jurisdiction to tax"). As this Court has recognized time and time again, the relationship between a resident and her government, and the attendant privileges and responsibilities embodied in that relationship, are unique. No-

table among those privileges and responsibilities is the right of residents to participate in the democratic process as citizens in determining how much tax they will pay and how those tax dollars will be spent.

Thus, in rejecting a claim that New York was barred by the Due Process Clause from taxing its residents on rents received from property in New Jersey, this Court held in *New York* ex rel. *Cohn v. Graves,* 300 U.S. 308, 312–313 (1937):

> That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil[e] itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government.... These are rights and privileges which attach to domicil[e] within the state.... Neither the privilege nor the burden is affected by the character of the source from which the income is derived.

Accord, Oklahoma Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 463 (1995).

The relationship between the Wynnes as residents and the state in which they have chosen to live does not change in character based upon the amount or nature of the income the Wynnes earn. Income taxes are founded on the principle—upheld many times by this Court—that taxpayers can be made to pay for the benefits of a civilized society based upon

their ability to bear those burdens. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 628-29 (1981); *Goldberg v. Sweet*, 488 U.S. 252, 266-267 (1989); *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 280-281 (1932).

This principle has been upheld even though some residents may pay more to receive a smaller direct benefit from the state, while other residents, such as retirees or the disabled, may be entirely exempted from income tax liability but receive greater benefits. By the same token, the relationship between the Wynnes and their state of residence does not change based on the geographic sources of the income they earn. A taxpayer might earn income from investment in another state or country's bonds, *Cook v. Tait*, 256 U.S. at 56, from stocks traded on a domestic or foreign exchange, *Shaffer v. Carter*, 252 U.S. at 57, from property held in trust by a distant bank, *Curry v. McCanless*, 307 U.S. at 368, or from a rental property in a neighboring state, *New York* ex rel. *Cohn v. Graves*, 300 U.S. at 312, and yet the mutual obligations between the state and its residents remain the same. Any one of these activities carried out by a taxpayer could be considered engaging in interstate or foreign commerce.

Under the Maryland Court of Appeals' application of the "fair apportionment" standards, any of the circumstances listed above could be considered an impermissible discrimination against interstate or foreign commerce. This would presumably be true regardless of whether the underlying economic activity carried out in another state was or could be sub-

ject to tax there. But Maryland's tax is not intended to reflect the source of its residents' income.

C. The States that Tax the Wynnes on a Portion of the Income from Their Investment, Commensurate with the Protections and Benefits Provided in Those States, Do Not Duplicate or Conflict with Residency-Based Taxes.

The authority of a sovereign to impose tax on non-residents deriving income from property or businesses activities within that sovereign's borders is well-established. *Travis v. Yale & Towne Mfg. Co*, 252 U.S. 60, 72 (1920); *Whitney v. Graves,* 299 U.S. 366, 372 (1937); *Int'l Harvester Co. v. Wisconsin Dept. of Rev.,* 322 U.S. 435 (1944). The taxpayers have chosen to invest in a business operating in multiple states, enlisting the protections and benefits of governments in each of those jurisdictions. Expecting a taxpayer to pay for those protections and benefits does not offend the Commerce Clause nor was it the purpose of the "dormant" Commerce Clause to relieve those engaged in interstate commerce from paying for the costs of maintaining a civilized society. *Western Live Stock v. Bureau of Rev.*, 303 U.S. 250, 254 (1938).

The authority of a state to impose tax on all of its residents' incomes and the authority of a state to impose tax on business or property generating income within its borders are not in conflict or competition here. The states in which Maxim operates provide services and protections that benefit the Wynnes as investors. The protections extended to their investment by those states do not reduce the

benefits and privileges the Wynnes receive as residents of Maryland, including access to free primary and secondary public education, reduced college tuition and access to various public welfare benefits. *See Br. of Pet.* at 20-22.

The taxpayers make no claim that the taxes they pay in other states are not rationally related to the protections afforded to them. Maryland's decision to limit the amount by which its residents may reduce their tax obligations to the state based on obligations owed to other states has no Commerce Clause implications since its residents are not being taxed in Maryland as commercial actors; they are being taxed as residents.

D. The Commerce Clause is Not Implicated Merely Because Taxpayers Investing in Multistate Businesses May Pay Tax in Multiple States in Addition to Residency-Based Taxes.

The Maryland Court of Appeals concluded that Maryland's decision to afford its residents only a partial credit for taxes paid to other states constitutes impermissible discrimination under the dormant Commerce Clause. *Wynne*, 64 A.3d at 465-66. It came to this conclusion because a Maryland resident investing in a corporation treated as a pass-through entity for tax purposes which confined its operations to Maryland would pay less tax than a Maryland resident investing in a business operating in multiple states if those states sought to impose a source-based tax on the Maryland resident. *Id.*

The differences in potential tax burden are not a

result of Maryland's taxing policies, which make no distinction between income earned within the state and income earned elsewhere. *Cf. Fulton Corp. v. Faulkner,* 516 U.S. 325 (1996)(reduction in intangibles tax based on dividend-payors' operations within the state). The potential differences in tax burden, as noted by the dissent below, arise because the taxpayers enjoy the protections and benefits of multiple jurisdictions, and therefore should expect to pay for maintaining government in each jurisdiction. *Wynne,* 64 A.3d at 472 (Greene and Battaglia, JJ., dissenting).

The Commission maintains that the *Complete Auto* four-part test is inapplicable to a facially neutral tax imposed on a resident's income, from whatever source derived. But even if the test could be made to fit, the facts of the case do not support a finding of impermissible discrimination against interstate commerce.

Where a tax scheme facially discriminates between in-state and out-of-state activities, this Court has adopted a virtual *per se* rule of invalidity, unless the state can demonstrate compelling reasons for sustaining the tax. *Camps Newfound v. Town of Harrison,* 520 U.S. 564, 582 (1997) (*quoting Chemical Waste Mgmt. Inv. v. Hunt,* 504 U.S. 334, 342 (1992)) ("Once a state tax is found to discriminate against out-of-state commerce, it is typically struck down without further inquiry"). But where a taxing system makes no distinction between local and foreign activities, as here, this Court has required substantial evidence of actual discriminatory effects on

interstate commerce that outweigh the state's interests, even where some overlapping taxation with other state's taxing schemes is likely or inevitable. *Am. Trucking Ass'ns, Inc. v. Michigan Pub. Serv. Comm'n*, 545 U.S. 429, 432 (2005); *Oklahoma Tax Commission v. Jefferson Lines*, 514 U.S. 175 (1995); *Goldberg v. Sweet*, 488 U.S. 252 (1989).

In the absence of such evidence, this Court has not hesitated to uphold the states' sovereign interests in maintaining their taxing authority free from undue federal interference. *Barclay's Bank PLC v. Franchise Tax Board*, 512 U.S. 298, 318-320 (1994); *Container Corp.*, 463 U.S. at 192-193. The same lack of actual evidence of discriminatory effect coupled with the state's interests compels this Court to reverse the lower court's finding of impermissible discrimination in this case.

Any effect on interstate commerce arising from the application of Maryland's tax system, limited to its own residents, would be indirect, incidental, and completely speculative on this record. Moreover, Maryland has an overwhelming interest as a sovereign government in setting its own taxing policies, including its policy determination that its residents should bear the costs of government based on their ability to pay.

In *Am. Trucking Ass'ns, Inc. v. Michigan Pub. Serv. Comm'n*, *supra*, this Court was confronted with an analogous tax imposed entirely on intrastate activity: a $100 annual permit fee for registering each truck engaged in intra-state activity. The petitioners were engaged in both intrastate and interstate

hauling, and complained that if every state imposed a similar flat tax on purely intrastate activity, a trucking company electing to operate its trucks in multiple states would bear a higher tax burden than trucks electing to confine their activities to a single state. *Id.* at 432. Although this Court had previously struck down un-apportioned "axle taxes" that were borne more heavily by interstate trucking companies, *see Am. Trucking Assn's, Inc. v. Scheiner,* 483 U. S. 266 (1987), the Court upheld Michigan's tax for three reasons, all of which apply with far greater force in this case.

First, Michigan's tax on intrastate hauling, like Maryland's tax on its residents for the privilege of exercising the rights of domicile, fell exclusively on local activity. *Id.* at 434. In that circumstance, the Court held that the state's sovereignty interests in determining its own taxing policies are especially strong and outweigh merely incidental effects on interstate commerce. This Court wrote:

> [Michigan's tax] does not facially discriminate against interstate or out-of-state activities or enterprises. The statute applies even-handedly to all carriers that make domestic journeys. It does not reflect an effort to tax activity that takes place, in whole or in part, outside the State. Nothing in our case law suggests that such a neutral, locally focused fee or tax is inconsistent with the dormant Commerce Clause.
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> ***

> Although we have long since rejected any suggestion that a state tax ... affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to a local or intrastate activity, *Commonwealth Edison Co. v. Montana*, 453 U. S. 609, 615 (1981), we have also made clear that the Constitution neither displaces States' authority to shelter [their] people from menaces to their health or safety, *D. H. Holmes Co. v. McNamara,* 486 U. S. 24, 29 (1988) (internal quotation marks omitted), nor unduly curtail[s] States' power to lay taxes for the support of state government. *McGoldrick v. Berwind-White Coal Mining Co.,* 309 U. S. 33, 48 (1940).

Id. Second, the Court noted that the record failed to reflect a "significant practical burden" on interstate commerce. *Id.* at 435.

In the present case, there is likewise a complete absence of evidence that Maryland's partial tax credit impedes interstate commerce by encouraging Maryland residents to confine their investments to property interests in Maryland or businesses operating solely in Maryland. The effects of Maryland's decision to limit its credit for taxes paid to other states on the investment and business decisions of Maryland residents are completely hypothetical and speculative.

The Maryland Court of Appeals apparently concluded that evidence of actual discriminatory effects on interstate commerce was unnecessary because

Maryland's taxing system was "internally inconsistent." As this brief explains, Maryland's taxing system meets the internal consistency test because it falls on residents, not commerce, for the privileges of Maryland domicile. No other state can impose a tax on Maryland's residents on this basis.

Even if Maryland's tax on its own residents could be described as internally inconsistent, absent evidence of a significant effect on interstate commerce, it does not follow that the tax must be struck down under the Commerce Clause. This Court so held in *Am. Trucking Ass'ns, Inc. v. Michigan Pub. Serv. Comm'n*, after discussing the taxpayer's failure to provide evidence of discriminatory effects:

> Petitioners add that Michigan's fee fails the internal consistency test, a test that we have typically used where taxation of interstate transactions are at issue ... We must concede that here, as petitioners argue, if all States did the same, an interstate truck would have to pay fees totaling several hundred dollars, or even several thousand dollars, were it to "top off" its business by carrying local loads in many (or even all) other States. But it would have to do so only because it engages in *local* business in all those States.

545 U.S. at 436-438.

The final consideration cited in *Am. Trucking Ass'ns, Inc. v. Michigan Pub. Serv. Comm'n*, was fairness. 545 U.S. at 429. In the present case, the taxpayers concede that Maryland's tax on their in-

come is fairly related to benefits and services provided by the state. *Wynne*, 64 A.3d at 463. Nor do the taxpayers contest that the states in which Maxim operates also provide benefits and services for which they can ask something in return.

By virtue of the taxpayers' election of S corporation status for Maxim, Inc., the taxpayers have avoided the economic burden of entity level taxation at the state and federal level. The election of S corporation status, however, has not lessened the separate obligations of the state of Maryland and other states to protect the Wynnes and their business interests.

II. Imposing a Tax Credit Obligation on States Whenever Income is Taxed on a Residency Basis and a Source Basis Would Cause Profound and Unpredictable Disruption of State Taxing Systems.

This Court has upheld the concept that residents of a state (or the United States) can be required to pay tax on income received from whatever source without necessity of a legislative deduction or exemption system under the Due Process Clause. *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). Imposition of a different standard under the Commerce Clause based on notions of impermissible "double taxation" would trigger an onslaught of challenges to myriad state and local taxes which could be considered duplicative or overlapping in some fashion and would involve the courts in second-guessing state and local policy decisions.

Although the states do generally afford a credit for taxes paid to other states as a political choice, the extent of those credits varies significantly among the states. CCH, Smart Charts, 16-825, *Credit for Taxes Paid to Another State.* States may currently limit credits on a number of bases, including whether the tax paid is a similar type of imposition to the tax imposed by the state (i.e., a tax on "income"), whether the tax is paid by the same taxpayer in the same period or on the same income, and whether the tax is imposed by a state to which the income was properly sourced.[4] As it pertains to this case, states may also limit the credit given to shareholders of corporations exempted from tax as Subchapter S corporations, allowing only a credit for taxes paid by the shareholders themselves, and not by the entity.[5]

Therefore, if the Maryland court's decision is upheld, it will be necessary for the courts of the state where a credit is claimed to determine whether other states' income, excise, franchise, or gross receipts taxes paid by resident individuals, or the entities in which they have invested, are equivalent to the tax against which the credit is claimed. *See, e.g.,* In re *Allcat Claims Svcs., LLP,* 356 S.W.3d 455 (Tx. 2011)(holding franchise tax on partnership was not personal income tax under Texas law); *Cf., Trinova Corporation v. Michigan Dept. of Treasury,* 498 U.S.

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[4] *See, e.g.,* KY. REV. STAT. ANN. § 141.070(1); ALA. CODE § 40-18-21(a)(1); COLO. REV. STAT § 39-22-108; IOWA CODE § 6-3-3-3(a); 45 IOWA ADMIN. CODE r. 3.1-1-7.

[5] *See, e.g., Boone v. Chumley,* 372 S.W.3d 104 (Tenn. Ct. App. 2011)(holding that credit for taxes paid did not extend to entity-level taxes);N.Y. TAX LAW § 620(d).

358 (1991)(discussing nature of Michigan's Single Business Tax).

Another immediate consequence of a holding affirming the Maryland court could be the necessity of determining whether credits must be granted for local taxes and foreign country taxes paid. *Cf. Kraft General Foods, Inc. v. Iowa Dep't of Rev.*, 505 U.S. 71 (1992)(state's reliance on federal dividend treatment for sourced-based taxation system discriminated against foreign commerce).

The nature of these questions and the absence of clear guidelines would inevitably involve the courts in making legislative and policy judgments in an area of significant importance to the states, that is, how residents will be taxed. This Court has declined to exercise that type of role in the past. *Moorman*, 437 U.S. at 280; *Am. Trucking Assoc. v. Michigan*, 545 U.S. at 18; *Goldberg v. Sweet*, 488 U.S. at 261 (1989). This Court's reluctance to "constitutionalize" state tax policy choices stems not only from a desire to respect legislative boundaries but also from a respect for state sovereignty. *See, e.g., National Private Truck Council, Inc. v. Oklahoma Tax Comm'n*, 515 U.S. 582, 586 (1995), quoting *Dows v. City of Chicago*, 11 Wall. 108, 110 (1871) ("It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments, and it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible."); *Mobil Oil v. Vermont*, 445 U.S. 425 (1980)(declining to impose single method of dividend taxation); *Wisconsin v.*

J.C. Penney Co., 311 U.S. 435, 444 (1941); *Tully v. Griffin*, 429 U.S. 68, 73 (1976). *Cf., Dep't of Rev. of Oregon v. ACF Industries, Inc.*, 510 U.S. 332, 345 (1994)(noting that federalism concerns "compel" narrow construction of federal statutory restrictions of state tax authority).

For almost a century, this Court has upheld the authority of states to impose taxes on all the income of their residents, regardless of source, despite the unquestioned authority of other states to also tax a portion of the same income on a source basis. Upholding the Maryland Court of Appeal's determination that the state of residence must yield its authority when other states chose to impose tax would open the floodgates to a wave of litigation over what constitutes duplicative taxation requiring a credit. In the longer term, upholding that decision would undermine the states' ability to adopt tax policies that would raise revenues based on the ability of residents to pay for government services.

CONCLUSION

For the reasons set forth above, *amicus* Multistate Tax Commission urges this Court to reverse the decision of the Maryland Court of Appeals and affirm the authority of states to tax the total incomes of their residents in a non-discriminatory manner.

Respectfully submitted,

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August 5, 2014

AMICUS CURIAE BRIEF

No. 13-485

IN THE

Supreme Court of the United States

COMPTROLLER OF THE TREASURY
OF MARYLAND,

Petitioner,

v.

BRIAN WYNNE, ET UX.,

Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF *AMICUS CURIAE* THE NATIONAL ASSOCIATION OF PUBLICLY TRADED PARTNERSHIPS IN SUPPORT OF RESPONDENTS

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INTEREST OF THE AMICUS CURIAE[1]

The National Association of Publicly Traded Partnerships (NAPTP) is a trade association representing publicly traded limited partnerships, more commonly known as master limited partnerships (MLPs). NAPTP currently has 157 full and associate members and represents 100 MLPs.

MLPs have been in existence since 1981, and they were first created to allow businesses to raise capital from individual investors who could not afford the more sizeable investments often demanded by non-traded partnerships. The majority of the investors providing this capital are individual investors, many of whom are seniors. Seniors are particularly attracted to this form of investment because it generates a steady stream of reliable revenue.

The MLP structure was designed for capital-intensive businesses with a lower (but steady) general rate of return. One good example is the Nation's energy pipeline system. MLPs own approximately 300,000 miles of energy pipelines, a vast network ranging from local gathering lines that supply processing plants with products from the field to major interstate pipelines traversing thousands of miles. This system requires considerable upfront capital but once these assets are in place, they last a long time and generate a steady and reliable stream of revenue.

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[1] Pursuant to Rule 37.6, *amicus* states that no counsel for a party authored this brief in whole or in part, and no person or entity, other than *amicus* and its counsel, made a monetary contribution to the preparation or submission of this brief. As reflected in the letters filed with the Clerk, all parties have consented to the filing of this brief.

While steady and reliable, the income from such assets is often low in relation to the amount of capital expended, particularly in the case of rate-regulated pipelines. For this reason, corporate energy companies have increasingly preferred to divest themselves of these low-return assets and to put their capital into more profitable exploration and drilling operations; when they do, these pipelines are typically acquired by MLPs.

The taxation of MLPs differs from the standard two-level corporate form. As a general matter, partnerships are treated as "pass-through" entities for tax purposes. No tax is paid at the partnership level. A partnership's income is considered earned by all the partners; it is allocated among all the partners in proportion to their interests in the partnership, and each partner pays tax on his or her share of the partnership income.

Historically, all MLPs were taxed in this fashion,[2] with all income "passing through" the partnership to the individual investors, who then paid tax on their share of the net income generated by the MLP to their State and local taxing authorities. However, Congress adopted provisions in the federal tax code in 1987 (and expanded them in 2008) that limited "pass-through" tax treatment to publicly traded partnerships engaging in certain types of activities, primarily in the natural resources sector. MLPs proved highly sensitive to these changes in the tax code and, as a result, natural resource MLPs constitute about 80 percent of MLPs by number, and about 90 percent of the MLP market capital. At the end of March 2013, the total market capital of MLPs was about $445 billion,

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[2] The first MLP began trading in 1981.

of which just under $400 billion was in the natural resource sector.

The issue presented by this case has serious ramifications for the continued viability of MLPs. Both the Petitioner and his *amici* contend that States have the power to impose unlimited double taxation on out-of-state income of their residents, including those who receive income from pass-through entities, taxing them a second time on interstate income that was already taxed by the State where it was earned. If adopted by this Court, such a rule would upset the settled expectations of partnership owners, whose interstate earnings are currently taxed a single time because state taxing authorities, other than Maryland, fairly apportion tax responsibilities according to where the income is earned. Going forward, the prospect of Nationwide double taxation of income would be a disincentive to potential investors, causing them to invest elsewhere. The fundamental change advocated by Petitioner and his *amici* thus threatens to shrink a valuable source of capital for a critical segment of our Nation's energy sector. NAPTP therefore has a strong interest in the outcome of this case.

SUMMARY OF ARGUMENT

Petitioner and his *amici* attempt to frame this case as one about whether States and localities have the ability to tax the income of their residents earned through interstate commerce. Pet. Br. at 11-12, 18-24; U.S. *Amicus* Br. at 9-15. But, as in all cases involving multiple taxation, there is no dispute that Maryland has some power to tax all of its residents' income; the problem is that another jurisdiction also unquestionably has the power to

tax exactly the same income. The real question here, then, is not whether the Due Process Clause allows state and local jurisdictions to tax the income their residents generate through interstate commerce but whether that power is unfettered, notwithstanding the limits on state and local taxes that have been traditionally imposed by the Commerce Clause. This Court's precedents make clear that the answer to such a question must be a resounding "no." A taxing regime like Maryland's, which places an unfair share of the tax burden on interstate commerce, and which rejects a fair and simple method of apportionment, runs afoul of the dormant Commerce Clause. Any other result would substantially impede the continued viability of businesses like those represented by NAPTP, and would unduly burden our Nation's economy.

ARGUMENT

As this Court has long held, the Congressional power to "regulate Commerce among . . . the several States," U.S. Const. art. I, § 8, cl. 3, imposes implicit limitations on "the ability of States and localities to regulate or otherwise burden the flow of interstate commerce." *Maine v. Taylor*, 477 U.S. 131, 151 (1986); *see also Am. Trucking Ass'ns, Inc. v. Mich. Pub. Serv. Comm'n*, 545 U.S. 429 (2005). This "negative" or "dormant" Commerce Clause prevents a State from "plac[ing] burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear." *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995). In short, when it comes to evaluating state taxation schemes on interstate revenues, the "Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or

that burden it by subjecting activities to multiple or unfairly apportioned taxation." *MeadWestvaco Corp. v. Ill. Dep't of Revenue,* 553 U.S. 16, 24 (2008); *see also Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983). These two principles work in tandem to "prohibit taxes that pass an unfair share of the tax burden onto interstate commerce." *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992).

Maryland's taxing regime does precisely that here, passing an unfair share of the tax burden onto Maryland residents who earn their income through interstate commerce. Such residents are virtually certain to face multiple taxation of the same income, while the intrastate income of Maryland residents is taxed only a single time. Maryland's tax regime improperly rejects a simple apportionment solution that is almost uniformly adopted by other state and local taxing jurisdictions around the country: providing a credit for tax paid to the jurisdiction in which the income was earned. Maryland's insistence on full taxation at the county level of out-of-state income with no apportionment is constitutionally impermissible under the Commerce Clause, and the Court should affirm the decision below invalidating it.

I. Maryland Impermissibly Taxes Interstate Income More Heavily Than Income Generated Entirely Within Maryland

The first problem with Maryland's taxing regime is that it discriminates against interstate commerce. Under this Court's Commerce Clause jurisprudence, state laws that tax interstate income more heavily than intrastate income are disfavored. *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330-31 (1996). As the Court has explained, it will treat a state tax law as discriminatory (and often invalid), when it "'tax[es] a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the state.'" *Chem. Waste Mgmt. v. Hunt*, 504 U.S. 334, 342 (1992) (citation omitted, alteration added).

The Court applied these principles in *Fulton Corp. v. Faulkner*, 516 U.S. at 333-36, to strike down a taxation scheme analogous in many ways to the one here. The scheme challenged in *Fulton* levied a .25% tax on the value of North Carolina residents' corporate stock, but allowed for a "taxable percentage deduction" based on the fraction of the issuing corporation's income subject to tax in North Carolina. Thus, under North Carolina's regime, if a resident owned stock in a corporation that did purely intrastate business, the resident would receive a deduction for the full amount of any tax because the corporation would have paid tax to North Carolina on 100% of its income. However, if a resident owned stock in a company that generated income outside of North Carolina, that resident would owe corporate stock tax because there could be no full deduction (and,

indeed, there would be little or no deduction unless the multistate corporation earned a large percentage of income in North Carolina). *Id.* at 328-30. The Court found that the state tax scheme was impermissibly discriminatory, explaining that a "regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage domestic corporations from plying their trades in interstate commerce." *Id.* at 333.

Maryland's taxing regime here suffers from the same flaws. Maryland imposes an up-to 3.2% county income tax on all of a resident's income, no matter where it is earned, and provides no credit for payments made to other States on that same income. Thus a Maryland resident who earns income by participating in interstate commerce is subject to multiple taxation while a Maryland resident who earns income solely within Maryland will face only a single tax. Just as in *Fulton*, such a taxing regime favors residents who earn their income in-state, and thus "tends, at least, to discourage [residents] from plying their trades in interstate commerce."

II. Maryland Improperly Rejects a Simple, Widely-Used System of Fair Apportionment

The Maryland regime also implicates a second fundamental strand of this Court's dormant Commerce Clause jurisprudence: the requirement that a taxing regime allow for fair apportionment as a means of preventing multiple taxation. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 445-46

(1980); *Cent. Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 663 (1948). As this Court has explained, "the central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg v. Sweet*, 488 U.S. 252, 260-61 (1989).

There is no one-size-fits-all measure of what constitutes fair apportionment, nor is mathematical precision required. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-80 (1978). Instead, courts must ask whether a state tax is internally and externally consistent. *Am. Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 285 (1987). To be internally consistent, "the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the . . . income being taxed." *Container Corp.*, 463 U.S. at 169. To be externally consistent, "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.* at 170.

Maryland's taxation apportionment "formula" cannot withstand scrutiny under either of these tests. Maryland imposes an up-to 3.2% county income tax on resident income, regardless of whether that income was earned in, and taxed by, a jurisdiction outside of Maryland. And Maryland does so while at the same time taxing all income earned in Maryland by non-residents. Md. Code Ann., Tax-Gen. §§ 10-102, 10-106.1, 10-210(b)(3), 10-219, & 10-401. This latter feature of Maryland's formula is ignored by Petitioner and his *amici*, who assert that "[i]f every State taxed all the income of its own residents, *and only of its own residents*, there would be no plausible argument that

interstate commerce was disadvantaged." U.S. *Amicus* Br. at 24 (emphasis added).

But that is plainly *not* what Maryland's taxing regime does. Maryland's regime taxes the entire income not only of its own residents, but also of non-residents who generate income in Maryland. And as this Court's cases make clear, it is this entire taxing "regime" or "formula" that must be assessed under the Commerce Clause. *Fulton Corp.*, 516 U.S. at 333-36 (examining state taxing "regime" by looking not only to .25% tax but also to the manner in which State allowed taxpayers to reduce the tax through a deduction); *Container Corp.*, 463 U.S. at 169 (looking to state taxation "formula"). Properly assessed, such a taxing regime fails the internal consistency test because if all jurisdictions were to adopt Maryland's "formula" – taxation on 100% of resident income, plus taxation of all in-state income generated by non-residents, plus no credit for taxes based on income earned in other States – multiple taxation would inevitably result throughout the United States. That would unconstitutionally discourage and interfere with interstate commerce.

Likewise, such a regime fails the external consistency test because the factors used in the apportionment formula – 100% of the income is attributed to Maryland based on residency alone – do not reflect the reality of how income is generated. As the Respondents' case itself shows, in the modern economy Maryland residents can and do generate income from business conducted throughout the country. And, like Maryland, each state where that business is conducted understandably wants and collects its share of tax on that income. But income earned and taxed in

California is "generated" in California. By treating it as though it were generated in Maryland, Maryland's system is both fundamentally unfair and does not reflect reality.

This is not to say that the imposition of credits is constitutionally required in order to meet the fair apportionment requirement. All States, including Maryland, could meet the fair apportionment requirement by imposing taxes on their residents the same way they tax their non-residents – taxing only income generated in the State, and allowing other States to impose their own taxes on income generated elsewhere. Alternatively, States could choose to tax all of their residents' income regardless of where earned, but to provide credits for income taxes paid elsewhere. Virtually all States (including Maryland with respect to some portions of its income tax) have chosen the latter system of apportionment, presumably because it allows the State of residence to collect and keep tax revenues from out-of-state income generated in lower (or non) taxing States, and because it puts the burden of claiming credits on the resident taxpayer in the first instance. But whichever system is chosen, it must be fair, and it must attempt to allocate the tax based on where the income is generated. Maryland's system makes no such attempt, and thus it violates the Commerce Clause.

III. The Arguments Raised by Petitioner and His *Amici* In Support of Maryland's Discriminatory and Unfairly Apportioned Income Tax Scheme Cannot Withstand Scrutiny

Likely because Maryland's scheme is impossible to justify under the established standards for assessing whether a State tax violates the Commerce Clause, both Petitioner and his *amici* expend great effort in seeking to avoid those standards or to limit their application. These efforts cannot withstand scrutiny.

1. Petitioner's main contention (joined by *amici*, including the United States), is that this Court's decision in *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450, 462-63 (1995), resolved the question presented here by holding that "a jurisdiction, such as Oklahoma, may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." Pet. Br. at 2, 11, 18-20 (emphasis in original). But whether a jurisdiction has the power, as a matter of due process, to tax all of the income of its residents – the only question addressed in *Chickasaw Nation* – is largely beside the point. Just as in many of this Court's Commerce Clause decisions, there is no dispute here that the taxing State has the *power* to impose the tax at issue. Questions of multiple taxation arise, by definition, where multiple jurisdictions have the *power* to impose a tax on the same thing. At that point, the question under the Commerce Clause is whether each State's exercise of its undisputed power, in combination, impermissibly burdens interstate commerce. Such

a question was neither presented nor resolved by *Chickasaw Nation*.

Another case, however, did address the line between the Due Process Clause power to tax, and the potential for a state tax to unduly burden interstate commerce in violation of the Commerce Clause. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court had before it a tax dispute between North Dakota and an out-of-state mail-order retailer who had no physical presence in the State. The Court upheld North Dakota's power, under the Due Process Clause, to impose such a tax, but then held that the collection of such a tax violated the Commerce Clause by placing an undue burden on interstate commerce. In so holding, the Court clearly differentiated the two analyses, explaining "while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause." *Id.* at 305 & 313 n.7.

The line *Quill Corp.* drew between State's power to tax, on the one hand, and whether a state's tax unduly burdened interstate commerce on the other, was not a new one. In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. at 443-46, the Court addressed this same line in response to a taxpayer argument that was essentially the flip-side of the one Petitioner raises here. According to the taxpayer in *Mobil Oil*, its status as a domiciliary of New York meant that New York, and no other state, had the power to tax all of its dividend income. Thus, the argument went, Vermont's tax on the taxpayer's dividend income raised the threat of multiple taxation on the same dividend income, in violation of the Commerce

Clause. The Court rejected the argument, holding that even though New York theoretically had the power to tax all the dividends of its domestic corporations, there was "no reason" that "power should be exclusive[, especially] when the dividends reflect income from a unitary business, part of which is conducted in other States." *Id.* at 445-46. In these circumstances, the Court explained, "apportionment is ordinarily the accepted method." *Id.* at 446. Thus, the Court held that Vermont's interest "in taxing a proportionate share of appellant's dividend income is not overridden by any interest of the State of commercial domicile." *Id.*; *see also Standard Oil Co. v. Peck*, 342 U.S. 382, 384-85 (1952) ("The rule which permits taxation . . . on an apportionment basis precludes taxation of all of the property by the state of the domicile. Otherwise there would be multiple taxation of interstate operations . . . .") (internal citation omitted).

Thus, it is clear that the State's power to tax its resident's income consistent with the Due Process Clause does not trump any obligation to apportion under the Commerce Clause. The analysis under the constitutional provisions is separate, and to the extent this Court's precedents dictate a particular result, *Mobil Oil* strongly supports the decision below. Just as in *Mobil Oil*, there is no reason here why Maryland's power to tax its residents' income should be "exclusive," especially when those residents are conducting business in other States, and those other States also have the power to tax that same income. Under those circumstances, "apportionment is ordinarily the accepted method" of resolving competing claims among jurisdictions

that each possesses the undisputed power to tax the income.

2. In an attempt to distinguish the cases discussed above, the United States suggests that this case is different because it involves taxation of individuals, not corporations. According to the United States, the unique relationship between individuals and their state of residence makes other Commerce Clause cases irrelevant. U.S. *Amicus* Br. at 29-32. But nothing from this Court's Commerce Clause jurisprudence supports such a distinction – and the United States points to no case to support it. Indeed, the leading academic authority on state taxation has rejected it. 1 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 20.10[2][b](3d ed., Supp. 2014) ("In our view, a state has no more power . . . to tax individuals on 100 percent of their income earned from commercial activities . . . in other states than it has to tax corporations on 100 percent of their income earned from commercial activities that are taxable in other states. In both instances . . . a state's insistence on the right to tax 100 percent of the taxpayer's income would expose the taxpayer to an unconstitutional risk of multiple taxation.")

Nor is such a distinction tenable. This case involves the taxation of individuals operating an interstate corporation, which "passed through" its income to them. *Amicus* consists of MLP enterprises whose partners receive similar "pass through" income that is generated through interstate commerce. Like the corporations and their shareholders discussed in this Court's Commerce Clause decisions, the shareholders of S Corporations and the partners in MLPs have a keen interest in paying their fair share of taxes on

interstate income – but only their fair share. There is no reason to protect traditional corporate shareholders from the tax effects of multiple taxation imposed on corporations and not similarly protect the shareholders of S Corporations or MLP partners who do not operate in the traditional corporate form. Discriminatory and unfairly apportioned State taxes imposed on individuals who earn income from interstate commerce will have every bit as damaging an effect on the Nation's economy when applied to investors in MLPs as would similar taxes imposed on corporations.

Amicus can attest to the serious manner in which such a rule could interfere with interstate commerce. MLPs were designed to raise capital from smaller investors who desire a steady, reliable income stream. Since 1987, investments in MLPs have totaled in the hundreds of billions of dollars, and these investments are critical to the operation of capital-intensive businesses such as pipelines. Under our current interstate tax system, investors in MLPs generate income from a variety of States but pay only a single tax on this income because most States provide credits to their residents for tax paid on income earned in other States. But if Petitioner prevails, investors in MLPs will be subject to tax on the income where it is earned, and then can constitutionally be made subject to the same income tax on the same income (with no corresponding credit) in their place of residence. Such double taxation of MLP investors would make these investments less viable. And if these investments are threatened, the important businesses they fund may be endangered as well.

Nor is there a sound basis for sharply differentiating between an individual's residence and a corporation's place of domicile. As this Court's recent cases make clear, a corporation has a connection with its home state like that of an individual resident. *Daimler AG v. Bauman*, 134 S. Ct. 746, 760 (2014). While the United States argues that corporations can theoretically be "at home" in more than one place, U.S. *Amicus* Br. at 31 n.7, the States are more than capable of creating overlapping definitions of "residence" for individuals as well. *See generally* Seth Goldstein, *"Resident" Taxpayers: Internal Consistency, Due Process, and State Income Taxation*, 91 Colum. L. Rev. 119, 124 (Jan. 1991) ("Due to the various definitions of resident, more than one state may claim the same taxpayer as a resident.") In short, there is no legally tenable reason why the principles this Court has applied to multiple taxation of corporations should not also apply to multiple taxation of individuals.

Nor is it any answer for the Petitioner to hypothesize situations in which Maryland could get zero income tax from a Maryland resident who earns all income in other States and receives a credit for the entire amount of his or her Maryland income tax. Pet. Br. at 23. In the first place, the theoretical situation postulated by Petitioner is apparently so rare that no one cites a single example of this occurring. It is also notable that Respondents' case clearly does not present such a situation. Resp. Supp. Br. at 12 (stating Respondents paid over $50,000 in Howard County income taxes even with credits due to Maxim's in-state business and Brian Wynne's Maryland salary). But even if that scenario were to occur,

Maryland, like other States, levels a host of other sales and property taxes on residents, thus still generating tax revenues from those rare residents who earn all of their income elsewhere.

Petitioner's scenario also ignores the manner in which such anomalous situations would counterbalance each other. It is undisputed that Maryland taxes non-residents on income generated in Maryland. In the Petitioner's hypothetical, then, Maryland could get 100% of the tax on a California non-resident who generates all of his or her income in Maryland. This evens out any shortfalls, and in fact the balance from a credit system is likely tilted in Maryland's favor. A credit system allows Maryland to tax its residents who generate income from interstate commerce conducted in States that have no tax on income based on the entirety of this commerce even though a value-based system might provide Maryland with less tax revenue.

In short, none of the arguments raised by Petitioner and his *amici* can justify what is unquestionably a discriminatory and unfairly apportioned taxing regime.

CONCLUSION

For the foregoing reasons, the Court should affirm the judgment of the Maryland Court of Appeals.

Respectfully submitted,

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AMICUS CURIAE BRIEF

RECORD AND BRIEFS

No. 13-485

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IN THE

Supreme Court of the United States

COMPTROLLER OF THE TREASURY
OF MARYLAND,

Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

ON WRIT OF CERTIORARI TO THE
COURT OF APPEALS OF MARYLAND

BRIEF FOR THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS SMALL BUSINESS LEGAL CENTER AND THE NATIONAL ASSOCIATION OF HOME BUILDERS AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Does the Commerce Clause permit a State to apply a substantial component of its individual income tax to a resident's income earned from a multistate business without permitting any form of apportionment to avoid the multiple taxation of interstate commerce?

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INTEREST OF *AMICI CURIAE*[1]

The National Federation of Independent Business ("NFIB") is the Nation's leading small business advocacy association, representing more than 350,000 member businesses in all fifty States and the District of Columbia. NFIB's members range from sole proprietors to firms with hundreds of employees, and collectively they reflect the full spectrum of America's small business owners. Founded in 1943 as a nonpartisan organization, NFIB defends the freedom of small business owners to operate and grow their businesses and promotes public policies that recognize and encourage the vital contributions that small businesses make to our national economy. On the subject of taxes in particular, NFIB is committed to advocating for federal and state policies that provide tax relief, consistency, and certainty for small business owners across the United States.

NFIB's Small Business Legal Center is a nonprofit public interest law firm that provides legal resources to NFIB's members and serves as the voice of small business in the courts. Through its Small Business Legal Center, NFIB has asserted claims in court to protect the interests of small business owners—*see, e.g.*, *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. ___, 132 S. Ct 2566 (2012)—and frequently files amicus briefs in cases of consequence to America's small businesses, including in this Court. *See,*

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1. All parties have consented to the filing of this brief in letters on file with the Clerk of the Court. No counsel for a party has authored this brief in whole or in part, and no person other than *amici curiae*, their members, and their counsel has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.

e.g., Br. for NFIB Legal Center as *Amicus Curiae* in Support of Resps., in *NLRB v. Noel Canning*, No. 12-1281 (U.S. filed Nov. 25, 2013); Br. for NFIB Legal Center as *Amicus Curiae* in Support of Resps., in *Christopher v. SmithKline Beecham Corp.*, No. 11-204 (U.S. filed Mar. 26, 2012).

The National Association of Home Builders ("NAHB") is a Washington, D.C.-based trade association whose mission is to enhance the legal and economic climate for the home-building industry. Chief among NAHB's missions is to provide and expand opportunities for all people to have safe, decent, and affordable housing. Founded in 1942, NAHB is a federation of more than 800 state and local associations. About one-third of NAHB's more than 160,000 members are home builders or remodelers, and its builder members construct about 80 percent of the new homes each year in the United States.

Amici are submitting this brief because the present case raises an issue of vital importance to their members and to all of America's small businesses. By denying residents who own small businesses a tax credit for income taxes paid to other States, Maryland's income tax scheme guarantees that small business owners whose businesses engage in interstate commerce are subjected to multiple, overlapping taxation. If all States adopted tax schemes like Maryland's, the disproportionate tax burden on the income of small multistate enterprises would destroy the incentives of America's small business owners to engage in interstate commerce—a result impossible to square with the Commerce Clause of the Constitution and with the Founders' vision of a single national commercial union.

BACKGROUND

This Court has consistently held that the Commerce Clause requires state taxes on corporate income to be fairly apportioned among the various taxing States to avoid multiple taxation of interstate commerce. The present case requires the Court to decide whether the same established rule also governs when a State taxes the interstate income of resident small business owners as individuals. The background facts relevant to the case are these:

1. For individuals who reside in Maryland, there are two components to the State's income tax: the "state tax" component and the "county tax" component, both collected by petitioner the Maryland State Comptroller of the Treasury. *See* Md. Code Ann., Tax-Gen. §§ 10-103, 10-105, 10-106; App. 4. Each component is calculated as a percentage of the taxpayer's adjusted gross income, as reported on the taxpayer's federal tax return, and thus both apply to the individual's total income from all sources, wherever earned. *See* Md. Code Ann., Tax-Gen. §§ 10-101 to 10-103, 10-203. The graduated rates used for the "state" component are the same for all Maryland residents, while the rate used for the "county" component varies depending on the individual taxpayer's county of residence (but may not exceed 3.2 percent). *See id.* § 10-105; *Frey v. Comptroller*, 422 Md. 111, 125-27, 29 A.3d 475, 481-84 (2011).[2]

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2. In lieu of the "county" component, individuals who are subject to Maryland income tax but have no county of residence in Maryland are assessed a "Special Non-Resident Tax" ("SNRT") at a rate equal to the lowest "county" tax rate. Md. Code Ann., Tax-Gen. § 10-106.1; App. 5.

One important difference between the "state" and "county" components of the Maryland individual income tax is critical to this case: Maryland permits the taxpayer to claim a credit against the "state" component for any taxes paid to other States on income attributable to those States, provided Maryland receives a "state tax" payment that is no less than it would receive if it applied the tax only to the Maryland portion of the taxpayer's income. *See* Md. Code Ann., Tax-Gen. § 10-703(c); App. 5-7. However, Maryland expressly denies any similar credit against the "county" component of the State's individual income tax and thus does not allow any apportionment of the "county tax" to account for taxes paid on the same income to other States. *See* Md. Code Ann., Tax-Gen. § 10-703(a); *Comptroller v. Blanton*, 390 Md. 528, 890 A.2d 279 (2006); App. 7.

As a result, an individual Maryland resident who earns a substantial portion of income from sources outside Maryland, such as the owner of a small business operating in multiple States, must pay the full "county tax" component of the Maryland income tax (up to 3.2 percent of the taxpayer's total adjusted gross income, including out-of-state income), even though the individual also pays a tax on the same income to each of the other States where the income is earned. For this reason, individual residents of Maryland who pay income tax to other States on income earned outside Maryland will inevitably bear a higher overall income tax burden than residents who earn their income entirely within the State of Maryland. *See* App. 19-23. Maryland appears to be the only State that refuses to apportion a significant component of the State's individual income tax by denying resident taxpayers a credit (or any

other form of apportionment) for taxes paid to other States on income attributable to those other States.[3]

2. Respondents are a married couple who resided in Howard County, Maryland, during the relevant tax year and were part-owners of Maxim Healthcare Services, Inc. ("Maxim"), a commercial business founded in Howard County that provides healthcare services throughout the United States. App. 8-9, 55. Maxim qualifies as a "small business corporation" under the Internal Revenue Code and has elected to be treated for federal income tax purposes as an S corporation. *See* 26 U.S.C. § 1361(a) & (b) (defining "S corporation" and the qualifications of a "small business corporation" eligible for tax treatment

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3. *See* 1 Walter Hellerstein, *State Taxation* ¶ 20.10 (3d ed. 2013) ("[E]very state with a broad-based personal income tax provides a credit for taxes that their residents pay to other states, thereby reverting the final tax to the state that is the source of the taxed income.") (footnote omitted); 2 CCH All States Tax Guide ¶ 15-110 (2003). Two States that assess only a limited personal income tax on income from intangibles, New Hampshire and Tennessee, do not grant such a credit. *See* Hellerstein, *supra*, ¶ 20.10 n.737. As petitioner's *amici* point out, some cities and other local taxing authorities assess income taxes on their residents without granting a full credit for taxes paid to other jurisdictions. *See* Br. for Int'l Muni. Lawyers Ass'n, *et al.*, as *Amici Curiae* in Support of Petr. ("IMLA Br.") 17-18 (citing tax provisions). In addition, Wisconsin denies a credit for income taxes paid "to a county, city, village, town or foreign country," Wisc. Admin. Code Tax § 2.955(3)(d), and North Carolina denies a credit to *non-resident* taxpayers for a tax paid on income earned in another State or foreign country that is assessed on the basis of residency or domicile, N.C. Gen. Stat. § 105-153.9(a)(1). It is inaccurate to suggest, as petitioner's *amici* do, that these tax credit provisions are "similar" to Maryland's, IMLA Br. 17.

as an S corporation). Under the federal tax code, the business income and losses of an S corporation, like that of a partnership, are "passed through," subject to certain limitations, to the owners of the business, who are then taxed on the income of the business as if they earned it directly. *See id.* §§ 1363, 1366. Like the federal government, Maryland also taxes the business income of S corporations on a pass-through basis, treating it as the individual income of the owners. *See* App. 8; Md. Code Ann., Tax-Gen. §§ 10-102.1, 10-104(6), 10-304(3).

During the relevant tax year of 2006, respondent Brian Wynne was one of seven owners of Maxim and held 2.4 percent of its stock. App. 9. Much of respondents' reported income for 2006 was pass-through income of Maxim, and a substantial portion of Maxim's income was generated in other States. *See id.* at 9, 56. Maxim filed state income tax returns in 39 States, and respondents were allocated a pro-rata share of the taxes paid to the various States on Maxim's income. *Id.* at 9. Respondents claimed a credit on their 2006 Maryland tax return for their allocated share of the income taxes paid to other States. *Id.* Petitioner allowed them a credit against the "state" component of the Maryland individual income tax but denied any credit against the "county" component, and respondents appealed. *Id.* at 9-10.

3. The Maryland Tax Court affirmed the tax assessment, App. 130-41, but the Circuit Court for Howard County reversed, agreeing with respondents that the State's denial of a tax credit unfairly discriminates against interstate commerce in violation of the Commerce Clause. App. 53-129. The Court of Appeals of Maryland affirmed. App. 1-49. The court concluded that Maryland's

denial of the tax credit results in "significantly different treatment for a Maryland resident taxpayer who earns substantial income from out-of-state activities when compared with an otherwise identical taxpayer who earns income entirely from Maryland activities" and therefore "creates a disincentive" for the owners of S corporations and other small businesses in Maryland to engage in commerce in other States. *Id.* at 16. For these reasons, the court held that Maryland's tax scheme violates the Commerce Clause requirements of fair apportionment and non-discrimination applied by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and subsequent cases. *See* App. 17-32.

SUMMARY OF ARGUMENT

The judgment of the Maryland Court of Appeals should be affirmed. Maryland's individual income tax is unconstitutional as applied to resident small business owners whose income derives from multistate business activities.

1. This Court's precedents firmly establish that when States tax the income or activities of a multistate business enterprise, including through a corporate income tax, "[t]he Commerce Clause forbids States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation." *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24 (2008); *see Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169-71 (1983). There is no sound basis to apply a different principle when States tax the income of a small business, like a partnership or S corporation, by taxing the owners of the business on a pass-through basis.

2. Maryland's decision to deny a credit against the "county" portion of the State's income tax for income taxes paid to other States by small business owners in Maryland is inconsistent with the Commerce Clause principle of fair apportionment. The Maryland tax scheme inevitably results in double taxation of business income and a substantially greater tax burden for small businesses that derive their income from interstate commerce versus purely local, intrastate businesses. If all States followed Maryland's lead, the freedom of commerce across state borders would be substantially encumbered because small business owners would be financially discouraged from expanding into out-of-state markets.

3. In addition, by expressly limiting any credit for out-of-state taxes paid by small business owners and thereby ensuring a greater tax burden for owners of multistate businesses, the Maryland individual income tax "facially discriminate[s] against interstate commerce," *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 200 (1995) (Scalia, J., concurring in judgment), and this discrimination alone provides a sufficient basis to conclude that the State's tax scheme violates the Commerce Clause without regard to principles of fair apportionment. *See id.* at 200-01; *see also Maryland v. Louisiana*, 451 U.S. 725, 756-57 (1981).

ARGUMENT

MARYLAND'S INDIVIDUAL INCOME TAX IS UNCONSTITUTIONAL AS APPLIED TO SMALL BUSINESS OWNERS WHOSE INCOME IS EARNED FROM BUSINESS ACTIVITIES IN OTHER STATES

The Commerce Clause, U.S. Const. Art. I, § 8, cl. 13, was designed to promote "the welfare of the Nation as a whole" by securing a free-trade zone for commerce among the States and avoiding "the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. at 179-80 (internal quotation marks omitted); *see Am. Trucking Ass'ns, Inc. v. Mich. Pub. Serv. Comm'n*, 545 U.S. 429, 433 (2005); The Federalist Nos. 7 (A. Hamilton), 11 (A. Hamilton), & 42 (J. Madison).

Just as surely as "the power to tax involves the power to destroy," *M'Culloch v. Maryland*, 17 U.S. 316, 431 (1819), Maryland's assumption of power to impose overlapping taxation on the multistate income of small business owners is a direct and intolerable threat to the free market of interstate commerce envisioned by the Framers of the Constitution. If Maryland may exercise this overreaching taxing power, all States may adopt the same scheme, and the result will be the destruction of incentives for small business owners to expand their operations across state lines.

A. The Commerce Clause Requires that State Taxes on Multistate Business Income Be Fairly Apportioned to Avoid Multiple Taxation of Interstate Commerce, and the Same Principle Applies with Equal Force When States Tax Small Business Income on a Pass-Through Basis

There is no doubt that if Maryland taxed the business income of respondents' company at the corporate level, rather than on a pass-through basis, Maryland's refusal to allow a credit (or any other means of apportionment) for taxes paid to other States on income earned by Maxim in those States would violate the Commerce Clause.

This Court has repeatedly held that when a State taxes the corporate income or activities of a "unitary business" operating in interstate commerce, the Commerce Clause requires the State to "apply a formula apportioning the income of that business within and without the State." *Container Corp.*, 463 U.S. at 169. "[T]he central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg v. Sweet*, 488 U.S. 252, 260-61 (1989); *see Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 445-46 (1980) ("[T]here is no reason in theory why that power [the taxing power of the State of domicile] should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method.").

This Court judges the adequacy of an apportionment formula using the so-called "internal consistency" test. *See, e.g., Container Corp.*, 463 U.S. at 169. "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, *no multiple taxation would result.*" *Goldberg*, 488 U.S. at 261 (emphasis added). A second, related test of fair apportionment is "external consistency," which "asks whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Id.* at 262.

One recognized benchmark method for assuring fair apportionment of a State's corporate income tax is the so-called "three-factor" formula reflected in the Uniform Division of Income for Tax Purposes Act, a uniform act adopted in most States that keys off the proportion of a business's sales, property, and payroll attributable to the taxing State. *See Container Corp.*, 463 U.S. at 164-65, 170.[4] Maryland itself applies this three-factor apportionment methodology when taxing business income under Maryland's corporate income tax code. *See* Md. Code Ann., Tax-Gen. § 10-402; 3 Md. Code Regs. § 4.03

4. The apportionment formula described in the Uniform Division of Income for Tax Purposes Act is an evenly weighted three-factor formula consisting of property, payroll, and sales factors. Today, many States use a variation of this formula whereby the sales factor is double-weighted, resulting in an apportionment formula that consists of a 25%-weighted property factor, a 25%-weighted payroll factor, and a 50%-weighted sales factor. Also, a considerable number of States use a single-factor apportionment formula that consists only of a sales factor. These variations on the apportionment formula described in the Uniform Division of Income for Tax Purposes Act are likewise designed to achieve fair apportionment, and their use does not alter our analysis.

(specifying that corporations engaged in multistate operations are to allocate income to Maryland based on the extent of the corporation's sales, property, and payroll activity in Maryland).

Another established and widely used mechanism for avoiding improper double taxation, of course, is the one Maryland has denied respondents—a credit for taxes paid to other States. *See D.H. Holmes Co., Ltd. v. McNamara*, 486 U.S. 24, 31 (1988) ("The Louisiana taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States.").

In applying these Commerce Clause principles, there is no legitimate basis to treat small business owners and their income differently from large corporations. The income of respondents' business Maxim, for example, is just as much business income derived from multistate commercial activities as is the income of the largest C corporation. It does not matter whether the corporation's income is taxed by a State at the corporate level (as would be the case in Maryland if Maxim were organized as a C corporation) or, as in this case, at the shareholder level and treated as the direct personal income of the business's owners.

Petitioner asserts that the purpose of the "county" component of Maryland's personal income tax is to compensate the State and its local jurisdictions for the benefits of residency conferred on individual taxpayers, and petitioner argues that this purpose justifies the denial of a tax credit for income tax payments made to other States on respondents' out-of-state income. Pet. Br. 20-24; *see* U.S. Br. 16-19. But the State of residency's interest in

funding the costs of local services cannot support a broad carve-out or exemption from the Commerce Clause's established requirement of fair apportionment in state taxation of multistate business income. *See D.H. Holmes Co.*, 486 U.S. at 29-30 ("The distinction between the power of the State [of domicile] to shelter its people from menaces to their health or safety and from fraud, even when those dangers emanate from interstate commerce, and its lack of power to retard, burden or constrict the flow of such commerce for their economic advantage, is one deeply rooted in both our history and our law.") (internal quotation marks omitted). States, in other words, may not fund local needs by imposing income taxes on interstate commerce that stifle the national free-trade zone protected by the Constitution. Petitioner's contention that Maryland must have the unfettered ability to tax the out-of-state income of residents in order to fund local state services proves too much, because corporations also make use of local services and yet this Court has held that a State may not subject corporations to double taxation.

B. Maryland's Refusal to Allow a Credit for Income Taxes Paid to Other States by Small Business Owners in Maryland Inevitably Results in Multiple Taxation on Small Businesses Engaged in Interstate Commerce in Violation of the Commerce Clause

In applying the "county" component of its individual income tax to income earned by small business owners whose businesses engage in interstate commerce, Maryland has made no effort whatsoever to apportion the tax so as to avoid double taxation of income and to limit the application of its tax to a fair measure of the portion

of the taxpayer's income that is reasonably attributable to Maryland. This denial of a tax credit will inevitably result in a significantly higher overall income tax burden for owners of multistate businesses versus those who confine their business activities entirely within Maryland.

The example laid out by the Maryland Court of Appeals shows in clear and simple terms how a Maryland resident who pays income tax to one or more other States on income earned from business activities in those other States will necessarily pay significantly more in income taxes than resident owners of wholly local, intrastate Maryland businesses. *See* App. 20-22. This differential financial burden follows from the assessment of income tax by both Maryland and one or more other States to income earned by the taxpayer outside Maryland, and therefore occurs by virtue of the interaction of Maryland's tax with the income tax laws of other States; nevertheless, the differential is caused by double taxation that is the inevitable and foreseeable product of the Maryland Legislature's policy decision to tax out-of-state business income by denying any tax credit against (or other method of apportionment for) the "county" portion of the Maryland income tax.[5]

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5. Contrary to the assertion of petitioner's *amici*, *see* IMLA Br. 5-6, respondents are not arguing for "a single bright-line" constitutional rule requiring States in all circumstances to grant "a full dollar-for-dollar credit for foreign income taxes." Rather, to be consistent with the Commerce Clause, a state income tax on multistate business income must incorporate some method of apportionment reasonably designed to avoid double taxation, and the substantial "county" component of Maryland's income tax violates this principle because it includes no mechanism for apportionment at all, whether a credit or otherwise.

The disparate tax burden falling on resident taxpayers who own multistate businesses will obviously discourage Maryland residents from starting or expanding interstate businesses. If Maryland is free to tax all out-of-state business income earned by its residents without limitation—without any credit or other means for apportioning its tax burden with the income taxes assessed by other States on income appropriately attributable to those other States—then all States may do the same, and the resulting rampant compound taxation of business owners will dramatically suppress incentives for American entrepreneurs to engage in cross-border commercial activities. "By encouraging economic isolationism," such an overreaching tax scheme manifestly entails "the very evil" that the Framers designed the Commerce Clause to prevent. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 578 (1997).

C. Maryland's Denial of a Tax Credit Facially Discriminates Against Small Business Owners Who Choose to Operate Multistate Businesses Rather than Limit Their Business Activities to Intrastate Commerce

By expressly limiting the credit for taxes paid on income generated outside Maryland to the "state" component of the Maryland income tax and thereby denying any such credit when applying the "county" component, Maryland's income tax code discriminates on its face against taxpayers who generate their income from interstate commerce.[6] The express limitation of

6. The Maryland code states that "a resident may claim a credit *only against the State income tax* for a taxable year . . . for State tax on income paid to another state for the year," Md. Code Ann., Tax-Gen. § 10-703(a) (emphasis added), and the Maryland

the credit to only one part of the income tax means that individuals who own small businesses like S corporations and partnerships and who choose to engage in business across state lines will incur a greater income tax burden than those who choose to confine their business activities to Maryland.

This facial discrimination against interstate commerce is anathema to our federal commercial union and must be rejected under any theory of the "negative" Commerce Clause, without regard to the other factors enumerated in *Complete Auto Transit* and its progeny. "State [tax] laws discriminating against interstate commerce on their face are virtually *per se* invalid." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) (internal quotation marks omitted).

In *Fulton Corp. v. Faulkner*, a unanimous Court struck down as facially discriminatory a North Carolina "intangibles tax" applied to the value of corporate stock owned by state residents that included a deduction based on the fraction of the issuing corporation's income that was subject to North Carolina tax. The result was that residents who owned stock of corporations doing business within North Carolina could claim the deduction, while the stock of corporations engaged entirely in business outside North Carolina was taxed at 100 percent of its value. *Id.* at 328. "There is no doubt that the intangibles tax facially discriminates against interstate commerce," the Court held, because "[a] regime that taxes stock only

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Court of Appeals has construed the highlighted language to mean that "[n]o credit is given against the county tax for income paid in other states." App. 7; *see Comptroller v. Blanton*, 390 Md. 528, 890 A.2d 279 (2006).

to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage domestic corporations from plying their trades in interstate commerce." *Id.* at 333. *See West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 210 (1994) (Scalia, J., concurring in judgment) (agreeing that negative Commerce Clause invalidates any state tax or other assessment that "facially discriminates against interstate commerce," whether in the initial assessment, in the granting of exemptions (like credits), or in the distribution of refunds or subsidies from the assessment); *see also Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. at 200 (Scalia, J., concurring in judgment).

Whether a state tax is facially discriminatory "must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme," and the Court's inquiry asks whether the State's tax code "will in its practical operation work discrimination against interstate commerce." *Maryland v. Virginia*, 451 U.S. at 756 (internal quotation marks omitted); *see id.* ("In this case, the Louisiana First-Use Tax unquestionably discriminates against interstate commerce in favor of local interests as the necessary result of various tax and exclusions."). Where, as in the present case, "[t]he obvious effect of" the State's scheme of limited tax credits "is to encourage [business] owners . . . to invest" in commercial activities within the State "rather than to invest in [similar business activities] in other States," this Court has had no difficulty condemning the scheme as discriminatory in contravention of the Commerce Clause. *Id.* at 757.

CONCLUSION

For the foregoing reasons, *amici curiae* the National Federation of Independent Business Small Business Legal Center and the National Association of Home Builders urge the Court to affirm the judgment of the Maryland Court of Appeals.

Respectfully submitted,

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AMICUS CURIAE BRIEF

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In the Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
Petitioner,

v.

BRIAN WYNNE, *et ux.*,
Respondents.

On Writ of Certiorari to the Maryland Court of Appeals

BRIEF OF THE TAX ECONOMISTS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether Maryland's decision to offer only a partial credit instead of a full credit to residents for taxes paid to other jurisdictions unconstitutionally discriminates against interstate commerce where the state has chosen to impose comparable tax burdens on income earned by residents within the state, by residents outside the state *and* by nonresidents within the state?

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INTEREST OF *AMICI CURIAE*[1]

Amici are scholars who specialize in the economic analysis of tax law and tax policy. *Amici* respectfully urge this Court to affirm the decision of the Maryland Court of Appeals. Standard conceptual tools familiar to economic analysis demonstrate that Maryland's income tax scheme does indeed discriminate against interstate commerce, although for different reasons than identified by the Court below. The discrimination does not stem from the risk that Maryland's tax could combine with the tax of some other jurisdiction so as to tax the same income twice. It stems instead from Maryland's decision to tax the income earned by residents within the state, residents outside the state and nonresidents within the state at comparable rates. The state's offer of a partial credit for taxes paid to other jurisdictions is insufficient to remedy the resulting inherent discrimination against interstate commerce.

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[1] Petitioner and Respondents have filed with the Clerk of the Court letters granting blanket consent to the filing of *amicus curiae* briefs. Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part, and no person or entity other than *amici* or their counsel made a monetary contribution to its preparation or submission.

Ohio State University, and an economist for the Joint Committee on Taxation of the U.S. Congress.

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cofounder and Vice President of the Progressive Policy Institute, advisor to the International Monetary Fund, and fellow of Harvard University, the National Bureau of Economic Research, and the Brookings Institution. Dr. Shapiro also has advised on economic policy issues President William Clinton, Vice President Albert Gore, Jr., U.K. Prime Minister Tony Blair, Treasury Secretaries Robert Rubin and Timothy Geithner, and then-Senators Barack Obama and Hillary Clinton. He is widely published on matters of economics and economic policy.

SUMMARY OF ARGUMENT

The Maryland income tax scheme at issue here is as discriminatory as any tariff. Its discriminatory nature does not arise, as the Maryland Court of Appeals reasoned, from the risk that it may combine with some other state's tax system to tax the same income twice. Rather, like an import or export tariff, Maryland's income tax scheme is discriminatory in and of itself because it systematically imposes tax burdens on interstate economic activity that are greater than the burdens imposed on economic activity conducted solely within Maryland. This discriminatory burden exists no matter how other states treat income earned in their jurisdictions.

Maryland has created this discriminatory burden as a result of its decision to tax both income earned by residents outside the state *and* income earned by nonresidents within the state at a comparable rate to the tax it imposes on income earned by residents within the state. In the terminology of cross-border tax policy, Maryland's tax on income earned by nonresidents within the state and the tax on income

earned by residents outside the state constitute taxes on "inbound transactions" and "outbound transactions," respectively. Taxes on such inbound and outbound transactions do not create separate and unrelated burdens on interstate commerce. On the contrary, because interstate commerce flows in both directions across state lines, these taxes *combine* to impose a double burden on cross-border activity. Incentives to engage in interstate commerce are unavoidably impaired when the combined tax burden on inbound and outbound transactions exceeds the tax burden on purely within-state transactions.

States have a wide range of options in designing tax schemes that would avoid such discriminatory impairment and that would be truly neutral as to interstate commerce. For example, states could tax only the income of residents wherever earned, or they could tax only income earned within the state, whether by residents or nonresidents. States could also tax both inbound and outbound transactions, as long as the combined tax burden does not exceed the tax on within-state transactions.

Most states, of course, do not have neutral income tax regimes because they tax inbound, outbound and within-state transactions at comparable rates. It is a near-universal practice, however, for such states to grant full credits to residents for taxes paid to other jurisdictions on their out-of-state income. While such an arrangement is not truly neutral, it has the advantage of mitigating the discrimination inherent in taxing inbound transactions, outbound transactions and transactions within the state at comparable rates. Indeed, a full credit eliminates the double burden on

cross-border activity whenever another state has an equal or higher tax rate. In contrast, however, a partial-credit scheme such as Maryland's *never* eliminates the double tax burden on interstate activity, regardless of other states' tax rates. Therefore, Maryland's decision under a 1975 amendment to its tax code to abandon its full credit for taxes paid to other jurisdictions has resulted in a tax scheme under which interstate commerce is always disadvantaged relative to within-state commerce.

Although the Maryland Court of Appeals misidentified the source of the discrimination by focusing on the risk of two states taxing the same income, it reached the correct substantive result by, among other things, applying this Court's well-established internal consistency test. Pet. App. at 19-23. As this Court has previously held, the internal consistency test can be used as a gauge of whether a given state's tax regime discriminates against interstate commerce and not simply as a measure of whether a state's tax burden is fairly apportioned among competing jurisdictions. The internal consistency test succeeds as a substantive indicator of such discrimination because it correctly measures the combined tax burden on inbound and outbound transactions and compares it to the tax burden on within-state transactions. Maryland's tax scheme violates the internal consistency test because, if every state adopted the same tax scheme, the tax burden on income earned by one state's resident outside the state would always be approximately 1.25 percentage points higher than the tax burden on income earned by a resident within the state. The Maryland Court of Appeals was therefore correct to strike down

Maryland's partial-credit scheme under the internal consistency test.

Maryland's partial-credit scheme also may be struck down as facially discriminatory. Maryland eliminated its full credit by enacting legislation in 1975 that increased the tax burden on cross-border activity—and cross-border activity alone—by restricting the potential scope of the credit offered for taxes paid to other jurisdictions. It is of no constitutional moment that this increased burden on interstate commerce was carried out through the reduction of a credit rather than through an increased tax rate.

Finally, the Court may reject each of the arguments offered by Petitioner in support of reversal. Contrary to Petitioner's argument, this case does not turn on the question of whether a state may tax all the income of residents wherever earned nor does it raise the question of whether a full credit for taxes paid to another jurisdiction is constitutionally required in all circumstances. There is nothing inherently discriminatory against interstate commerce about taxing residents' income wherever earned, even if it might result in two jurisdictions taxing the same income. However, where a state such as Maryland chooses to tax its residents' income wherever earned *and* the income of nonresidents earned within the state at roughly comparable rates, then it discriminates against interstate commerce. Maryland's partial credit for taxes paid to other jurisdictions falls short of providing a minimally acceptable mitigation of the resulting discrimination.

ARGUMENT

I. MARYLAND'S DECISION TO ELIMINATE THE FULL CREDIT IT ONCE OFFERED FOR TAXES PAID ON INCOME EARNED BY RESIDENTS OUT OF STATE HAS RESULTED IN A TAX SCHEME THAT NECESSARILY DISCRIMINATES AGAINST INTERSTATE COMMERCE.

A. Any Jurisdiction That Taxes Inbound, Outbound And Within-State Transactions At Comparable Rates Discriminates Against Interstate Commerce.

Assessing whether a statute discriminates against interstate commerce is the touchstone of this Court's dormant Commerce Clause jurisprudence. *Wyoming v. Oklahoma*, 502 U.S. 437, 454 (1992) ("It is long established that, while a literal reading evinces a grant of power to Congress, the Commerce Clause also directly limits the power of the States to discriminate against interstate commerce. . . . When a state statute clearly discriminates against interstate commerce, it will be struck down, unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism." (internal citations omitted)); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) (noting that a tax will survive scrutiny under the dormant Commerce Clause where the tax's "practical effect," *inter alia*, "does not discriminate against interstate commerce"). By invalidating discriminatory tax schemes, this Court has ensured that a state does not "place burdens on the flow of commerce across its borders that commerce wholly

within those borders would not bear." *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995). As a result, the Court has helped guarantee that the revenue measures for each taxing jurisdiction "maintain state boundaries as a neutral factor in economic decisionmaking." *Am. Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 283 (1987).

Petitioner asserts that Maryland's income tax scheme does not discriminate against interstate commerce because it imposes no greater tax rate on income earned out of state by residents than on income earned within the state by residents and because "residents are taxed evenhandedly on all their income, regardless of its origin." Pet. Br. at 35-36. According to Petitioner, Maryland's offer of a partial credit for taxes paid to other jurisdictions *favors* interstate commerce because it subjects interstate commerce to a lower tax rate than commerce within the state. *Id.* at 37 n.14. Petitioner's analysis, however, is fundamentally mistaken. It fails to consider the critical fact that interstate commerce flows in two directions across state lines. Taxes on income that flows out of the state and taxes on income that flows into the state are not separate and unrelated burdens on interstate commerce. Rather, these two taxes combine to impose a double burden on interstate commerce.[2] As discussed below, the Court's internal

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[2] The need to combine both inbound and outbound transaction taxes to assess how a given system changes incentives to engage in cross-border commercial activity has been discussed in economic and legal literature. *See, e.g.*, Joel Slemrod, Carl Hansen & Roger Procter, *The Seesaw Principle in International Tax Policy*, 65 J. Public Econ. 163 (1997); Ruth Mason & Michael S. Knoll, *What is*

consistency test reflects the need to consider both taxes.

Scholarship on income taxation refers to cross-border transactions that involve income-generating activity by residents outside the taxing state as "outbound transactions" and to cross-border transactions that involve income-generating activity by nonresidents within the state as "inbound transactions." Howard E. Abrams & Richard L. Doernberg, *Essentials of United States Taxation* §§ 29.2, 29.3 (1999). This terminology can be used to describe the two components of Maryland's cross-border tax scheme.

During the relevant 2006 tax year, Maryland imposed a tax on its residents' outbound transactions—*i.e.*, the income that its residents earned outside of the state—at a rate of 6.0 to 7.95 percent. This outbound transaction tax consisted of a state income tax of up to 4.75 percent and a county tax (also collected by the state) ranging from 1.25 to 3.2 percent, depending on the locality. Md. Code Ann., Tax-Gen. §§ 10-102, 10-103(a), 10-105(a), 10-106(a)(1) (2005); Revenue Admin. Div., Comptroller of Md., *State & Local Tax Forms & Instructions for filing personal state and local income taxes for full- or part-year Maryland*

Tax Discrimination?, 121 Yale L.J. 1014 (2012); Ruth Mason & Michael S. Knoll, *A Brief Sur-Reply to Professors Graetz and Warren*, 123 Yale L.J. Online 1 (2013). For a mathematical analysis, *see* Ryan Lirette & Alan D. Viard, *State Taxation of Interstate Commerce and Income Flows: The Economics of Neutrality* (Am. Enter. Inst. Econ. Policy Working Paper No. 2014-07, 2014), *available at* http://www.aei.org/papers/economics/state-taxation-of-interstate-commerce.

residents 10 (2006), *available at* http://forms.marylandtaxes.com/06_forms/residentbook.pdf. Maryland also imposed a tax on inbound transactions—*i.e.*, the income earned by nonresidents within the state—at a rate of up to 6.0 percent. This 6.0 percent inbound transaction tax consisted of the 4.75 percent state tax and a 1.25 percent Special Nonresident Tax ("SNRT"). Md. Code Ann., Tax-Gen. §§ 10-102, 10-105(a), 10-106.1 (2005). The SNRT applies to nonresidents in lieu of county income tax, although the county income tax applies to wages earned within a county by nonresidents living in localities that tax Maryland residents' wages. *Id.* §§ 10-103(a)(4), 10-806(c).

At all relevant times, the tax burden that Maryland imposed on cross-border activity therefore included an outbound transaction tax of up to 7.95 percent and an inbound transaction tax of up to 6.0 percent, for a combined total tax burden on cross-border transactions of up to approximately 13.95 percent.[3] The tax imposed on within-state transactions was far lower. It consisted of a state tax at a rate of up to 4.75 percent and a county tax at a rate ranging from 1.25 to 3.2 percent, for a maximum combined tax of 7.95 percent. *Id.* §§ 10-102, 10-103(a), 10-105(a), 10-106(a)(1). Because the combined tax burden on cross-border transactions

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[3] The exact combined burden arising from the 6.0 and 7.95 percent taxes is 13.473 percent. The combined tax burden is computed by adding the two tax rates and subtracting an interaction term equal to the first tax rate multiplied by the second tax rate, which reflects the fact that the second tax is deemed to be paid only on the income that remains after paying the first tax. *See* Lirette & Viard, *supra* note 2, at 10-11, 16, 19. A similar interaction term applies to all of the combined-tax-burden calculations in this brief.

substantially exceeded the 7.95 percent maximum tax on within-state activity, the tax scheme applied to Respondents' income was—and is—inherently discriminatory against interstate commerce. Indeed, the combined tax burden operates in exactly the same manner as any tariff to discourage cross-border activity.

It is important to be clear precisely why tariffs discriminate against interstate commerce while many other taxes do not. Some taxes are neutral as to interstate commerce because prices can adjust in the wake of the tax so as to preserve incentives to transact across state lines relative to incentives to transact solely within the state. In the case of a tariff or other similarly discriminatory tax, however, it is mathematically impossible for prices to adjust following the imposition of the tax so as to leave incentives to engage in interstate commerce unimpaired.

Consider two hypothetical states, A and B. Suppose that State A imposes a 20 percent tariff on the import of widgets costing $100 from State B. Prices for those widgets would have to rise in State A to preserve unchanged the incentives of buyers and sellers in State A and State B to transact among themselves. Because a State-B merchant could always earn $100 by selling a widget to a fellow State-B resident, that merchant's incentive to sell in State A can remain unchanged only if the price of State-A widgets were to rise to $125. At that price, a State-B merchant could recoup the same $100 after paying the 20 percent tariff, *i.e.*, a $25 tariff on a $125 sale. However, if widget prices in State A were to rise to $125, then State-A sellers would have no

incentive to sell their widgets to buyers in State B because they would earn only $100 in that jurisdiction.

State A's 20 percent tariff therefore creates a dilemma. If prices rise to $125 per widget in State A, then interstate commerce suffers because State-A sellers no longer have an incentive to trade with State B. If prices do *not* rise to $125 per widget, then interstate commerce suffers because State-B sellers no longer have an incentive to trade with State A. Either way, the tariff places interstate commerce at a disadvantage as compared to commerce within the state.

Maryland's combined tax on outbound and inbound transactions discriminates against interstate commerce in exactly the same manner as State A's tariff. Although Maryland taxes income-producing opportunities rather than widgets, the same analysis applies when considering whether returns on investment in those opportunities could potentially adjust to preserve incentives to transact across state lines.[4]

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[4] Petitioner claims that it is "hardly a self-evident proposition" that the Court's dormant Commerce Clause jurisprudence applies to individual income taxes rather than taxes on goods. Pet. Br. at 33. From an economic standpoint, however, it is self-evident. Just as the dormant Commerce Clause restricts a state from imposing a protectionist tariff that influences where widgets are sold, it should restrict discriminatory taxation of the income from widget production that would have similar effects. *See Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 404 (1984). Under Petitioner's logic, the Court's dormant Commerce Clause jurisprudence would also not apply to property taxes, a position squarely rejected by the Court in *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 574 (1997) ("A tax on real estate, like *any* other tax,

Suppose that State A taxes (i) income earned by its residents within the state at a 20 percent rate, (ii) income earned by residents outside the state (the outbound transaction tax) at a 20 percent rate, and (iii) income earned by nonresidents within the state (the inbound transaction tax) at a 20 percent rate. Under Petitioner's logic, State A's tax scheme would not discriminate against interstate commerce because it ostensibly treats everyone in exactly the same manner, taxing residents' in-state income at the same rate as nonresidents' in-state income and at the same rate as residents' out-of-state income.

In reality, however, State A's hypothetical tax regime is inherently discriminatory because it necessarily impairs incentives to engage in interstate commerce in the same manner as a tariff. If business opportunities in each state offered a $100 return in the absence of the tax, then the return would have to rise to $125 in State A to preserve unchanged the incentive for State-B residents to engage in interstate commerce with State A. At that return, a State-B resident could pay the 20 percent inbound transaction tax to State A and still receive the same $100 after-tax return the resident could earn by doing business in State B. However, if the return rose to $125, then State-A residents would prefer to do business in their home state rather than in State B. A State-A resident could earn $100 from that investment after paying $25 to meet the 20 percent within-state tax, but would earn only $80 by doing business in State B due to the need to pay the 20 percent outbound transaction tax.

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may impermissibly burden interstate commerce." (emphasis added)).

Contrary to Petitioner's reasoning, State A's tax scheme is not remotely neutral. Like a tariff, the state's taxation of both inbound and outbound transactions creates a dilemma. If the return rises to $125 in State A, then interstate commerce suffers because State-A residents no longer have an incentive to do business in State B. If the return does *not* rise to $125 in State A, then interstate commerce suffers because State-B residents no longer have an incentive to do business in State A. Either way, interstate commerce is placed at a disadvantage as compared to within-state commerce. The fact that the combined burden on interstate transactions exceeds the burden on transactions within the state prevents any possible adjustment from maintaining incentives to engage in interstate commerce.

Like the State-A tax scheme described above, Maryland's tax scheme is inherently discriminatory because it taxes both inbound and outbound transactions at rates comparable to its tax on within-state transactions. Therefore, the question presented in this case is whether a partial credit to residents for taxes paid to other jurisdictions—as opposed to the full credit that Maryland offered prior to the 1975 amendment of its tax code—is an appropriate means to mitigate the discrimination resulting from Maryland's decision to tax inbound, outbound and within-state transactions at comparable rates. As discussed below, it is not.

B. Maryland's Pre-1975 Provision Of A Full Credit On Outbound Transactions, While Not Perfectly Neutral, Mitigated The Discriminatory Burden On Interstate Commerce.

In an ideal world, states would avoid discriminating against interstate commerce by adopting truly neutral income tax regimes. With such neutral tax systems, it is possible for returns to adjust so that there is no incentive to shift from cross-border to purely within-state activity. Although in practical operation, returns may not actually adjust to preserve all incentives intact, neutral tax systems stand in sharp contrast to discriminatory tax regimes by preserving the potential for incentives to engage in cross-border activity to remain unchanged following imposition of the tax.

For example, a 20 percent tax by State A on all income earned within the state—whether by residents or nonresidents—is neutral as to interstate commerce. Economists refer to this tax as a "source-based" tax.[5] *See* A. Lans Bovenberg, *Residence- and Source-based Taxation of Capital Income in an Overlapping Generations Model*, 56 J. Econ. 267, 267-68 (1992).

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[5] If the return rose to $125 in State A, then State-B residents would continue to have the same incentive to do business in State A. After paying the 20 percent source-based tax to State A, a State-B resident would still earn the same $100 after-tax return that could be earned in State B. State-A residents would also earn a $100 after-tax return in State A because they would pay the same $25 source-based tax. Because they could earn the same $100 in State B, State-A residents would have no reason to prefer earning income in State A. Everyone's incentives to engage in cross-border activity would be preserved.

Similarly, a 20 percent tax by State A on the income of residents, wherever such income is earned, is neutral. Economists refer to this tax as a "residence-based" tax.[6] *See id.*

State A could also impose both a 20 percent source-based tax and a 20 percent residence-based tax, as long as residents' income earned within the state is subject to both 20 percent taxes.[7] The even-handedness of such an arrangement follows from the logic of neutrality. The source-based tax is neutral only if it taxes residents' in-state income at the same rate as residents' out-of-state income. The residence-based tax is neutral only if it taxes residents' in-state income at the same rate as nonresidents' in-state income. The combination of the two taxes is therefore neutral only if residents' in-state income is subject to both taxes, not just one of them. For this tax scheme, as with a source-based or

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[6] If the return remained at $100 in State A, then State-A residents would earn an $80 after-tax return after paying State A's 20 percent residence-based tax, whether they did business in State A or State B. State-B residents face no tax from State A and so would earn the same $100 return whether they did business in State A or State B. Everyone's incentives to engage in cross-border activity would be preserved.

[7] Residents' in-state income would then face a 36 percent tax rate, consisting of one 20 percent tax, followed by another 20 percent tax on the remaining 80 percent of income, reflecting the interaction term discussed in note 3, *supra*. If the return rose to $125 in State A, then State-A residents would earn an after-tax return of $80 in either state, paying a $45 tax on a $125 return in State A or a $20 tax on a $100 return in State B. State-B residents would earn an after-tax return of $100 in either state, paying a $25 tax on a $125 return in State A or earning $100 tax-free in State B. Everyone's incentives to engage in cross-border activity would be preserved.

residence-based tax, the combined burden on inbound and outbound transactions equals the tax burden on within-state transactions.

Instead of these neutral tax regimes, many states have adopted Maryland's general scheme of taxing inbound, outbound and within-state transactions at comparable rates, thereby imposing a higher combined tax burden on interstate commerce than on within-state commerce. *See, e.g.*, Walter Hellerstein *et al.*, *State and Local Taxation: Cases and Materials* 397 (9th ed. 2009) (noting that "the states generally tax residents on their income from all sources while taxing nonresidents on income from sources within the state"). In practice, however, states mitigate the combined tax burden on interstate commerce by offering residents a credit for income taxes paid to other jurisdictions. *Id.* States commonly allow credit for the other state's tax up to the amount of the tax on the relevant income imposed by the state granting the credit. *Id.* This widespread "full-credit" approach is not a complete solution to the discrimination against interstate commerce created by a state's decision to tax inbound, outbound and within-state transactions at comparable rates. However, it does provide some relief for such discrimination.

To see how a full-credit scheme mitigates the risk of discrimination, suppose that State A taxes (i) residents' in-state income at 20 percent, (ii) nonresidents' in-state income at 20 percent, and (iii) residents' out-of-state income at 20 percent with a full credit for taxes paid to other jurisdictions on that income. State B taxes all income earned within the state, whether by residents or nonresidents, at a rate equal to or greater than 20

percent. Because State A offers a full credit on taxes paid by its residents on income earned out of state, its effective tax rate on outbound transactions is zero.

With no tax on outbound transactions, State A's tax regime is now identical to a neutral source-based tax scheme that taxes only inbound and within-state transactions, taxing income earned in State A whether by residents or nonresidents. State A's tax regime is neutral because the combined burden on inbound and outbound transactions is only 20 percent, which exactly equals the 20 percent tax burden on transactions within the state. As discussed above, such a tax allows returns to adjust so that everyone's incentives to engage in interstate commerce are unimpaired.

Unlike a pure source-based or residence-based tax, however, a full-credit regime is not neutral in all circumstances. In particular, if State B's income tax rate were lower than State A's 20 percent rate, then State A's regime would remain discriminatory because it would still impose some tax on nonresidents' income from outbound transactions. Indeed, if State B had no income tax, then there would be no reduction whatsoever in State A's combined tax burden on inbound and outbound transactions.

Even though a full-credit regime is not perfectly neutral as to interstate commerce, such an arrangement is a widespread and long-standing means of mitigating the discriminatory burden on interstate commerce that otherwise results from taxing inbound, outbound and within-state transactions at comparable rates. The Court has upheld such full-credit arrangements in the past. *See, e.g., Henneford v. Silas Mason Co.*, 300 U.S. 577, 586-87 (1937) (upholding use

tax on out-of-state property that provided for credit for taxes paid to another jurisdiction in face of a Commerce Clause challenge). However, the fact that a full-credit regime may be constitutionally permissible under the dormant Commerce Clause does not mean that Maryland's partial-credit scheme is similarly permissible. Indeed, the contrast between the two regimes highlights the deficient nature of Maryland's partial-credit scheme. In particular, unlike a full-credit regime, Maryland's partial credit fails to offset the double burden on cross-border transactions resulting from Maryland's taxation of income earned on both inbound and outbound transactions no matter what tax rate another state might have. Maryland's partial-credit scheme is therefore inherently discriminatory in all circumstances.

C. In Contrast To A Full-Credit Regime, Maryland's Current Partial-Credit Scheme Discriminates Against Interstate Commerce In All Circumstances.

Instead of offering a full credit for income taxes paid by its residents to other states, Maryland provides only a partial credit. Residents may generally claim credit against the state portion of Maryland's income tax for taxes paid to other states on income earned in other states. This credit is limited to the increase in Maryland state income tax liability arising from the inclusion of the income earned in and taxed by other states. Md. Code Ann., Tax-Gen. § 10-703(a). The credit is not applicable to the county income tax. *Comptroller v. Blanton*, 390 Md. 528, 541-42 (2006).

Under this partial-credit scheme, the combined tax burden on cross-border activity always exceeds the tax burden on commercial activity that takes place solely within the state, thereby discriminating against interstate commerce in all circumstances. In the relevant 2006 tax year, Maryland taxed within-state transactions at up to 4.75 percent plus the county tax rate. Md. Code Ann., Tax-Gen. §§ 10-105(a), 10-106(a)(1) (2005). It taxed inbound transactions at the 4.75 percent state income tax rate plus the 1.25 percent SNRT, for a maximum combined tax burden of 6.0 percent. *Id.* §§ 10-105(a), 10-106.1. At best, the partial credit for taxes paid to other states could offset the 4.75 percent state tax on outbound transactions. *Id.* § 10-703(a). However, Maryland would still tax outbound transactions at the county rate because no credit applies to that portion of the tax. Under this scheme, the combined tax burden on inbound and outbound income always exceeds the tax burden on income earned by residents within the state by approximately 1.25 percentage points. The burden on outbound transactions would, of course, be even greater if the other state's tax rate were below 4.75 percent.

Because Maryland's combined tax burden on interstate commerce exceeds the burden on within-state commerce, the Maryland tax scheme creates an inherent bias against interstate commerce. Consider a Maryland resident facing a county tax rate of 1.25 percent, and suppose that another state imposes a 10 percent tax rate. The return in Maryland must be *at least* $95.74 to maintain incentives for the other state's residents to do business in Maryland. This is because the other state's resident would pay Maryland's 6.0 percent nonresident tax (where they will pay $5.74 tax

on the $95.74 return and net $90) rather than their home state's 10 percent tax rate. But the return in Maryland must be *no more than* $94.41 to maintain incentives for Maryland residents to do business in the other state. This is because Maryland's residents will pay 11.25 percent tax (10 percent tax to the other state and 1.25 percent county tax to Maryland) rather than Maryland's 6.0 percent tax (where they will pay $5.66 tax on the $94.41 return and net $88.75). There is no possible level of return at which incentives to transact across state lines remain unchanged. The maximum return that will preserve interstate incentives for Maryland residents is $1.33 less than the minimum return needed to preserve interstate incentives for the other state's residents. This resulting discriminatory burden is caused solely by Maryland's tax rather than by the other state's tax and is made even worse if the other state taxes income at a rate below 4.75 percent or imposes no tax at all.

The discriminatory nature of this partial-credit scheme does not depend on what other states may do. Rather, it is inherent in Maryland's own tax treatment of residents' in-state income, residents' out-of-state income and nonresidents' in-state income. If Maryland utilized a truly neutral tax regime, for example, by taxing only the income of residents wherever earned, there would be no constitutional need for a credit of any sort. Because the discrimination is of Maryland's own making, Petitioner's argument that a state should not be constrained from taxing its residents' out-of-state income merely because other states make an independent decision to tax that income is irrelevant. *See* Pet. Br. at 31.

Maryland's partial-credit scheme places a combined burden on cross-border transactions that always exceeds the burden on within-state commerce. It therefore places "burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear." *Jefferson Lines*, 514 U.S. at 180. As a result, the scheme fails to comport with the dormant Commerce Clause.

II. THE COURT'S INTERNAL CONSISTENCY TEST REVEALS THE INHERENTLY DISCRIMINATORY NATURE OF MARYLAND'S TAX SCHEME.

The Court need not develop any new legal rubric to compare the combined tax burden on inbound and outbound transactions against the tax burden on within-state commerce, nor need it employ any analysis of potential price adjustments. The Court can rely on its well-established internal consistency test. The internal consistency test asks whether, if the tax scheme at issue were adopted by all fifty states, interstate commerce would be disadvantaged compared to within-state commerce. *Jefferson Lines*, 514 U.S. at 185. A tax is internally consistent if such hypothetical universal adoption of the tax would impose no greater burden on interstate transactions than that imposed on within-state transactions. *Id.*

The test is not, as Petitioner maintains, merely a means to assess whether a given state's tax is fairly apportioned when several jurisdictions are taxing a unitary, multistate enterprise. *See* Pet. Br. at 38. As this Court has previously held, the internal consistency test also "applies where the allegation is that a tax on its face discriminates against interstate commerce."

Armco Inc. v. Hardesty, 467 U.S. 638, 644 (1984). The internal consistency test is indeed an appropriate and practical means to measure whether a tax scheme discriminates against interstate commerce because it compares the tax burden on within-state transactions to the combined tax burden on both inbound and outbound transactions. If the challenged tax regime were copied by every state, then each interstate transaction would be taxed as an inbound transaction in one state and as an outbound transaction in another state. The "hypothetical" nationwide tax used as the basis for the test is therefore simply the combination of the state's tax on inbound and outbound transactions.[8]

The point is illustrated by the Court's decision in *Armco Inc. v. Hardesty*, where the Court analyzed West Virginia's gross receipts tax scheme. That scheme had three key elements. First, West Virginia imposed a gross receipts tax of 0.27 percent on entities engaged in selling tangible property at wholesale. *Armco*, 467 U.S. at 642. Second, West Virginia exempted local manufacturers from that tax. *Id.* Third, West Virginia imposed a separate 0.88 percent tax on entities that manufactured tangible property in the state. *Id.*

West Virginia unsuccessfully defended its tax scheme on the same grounds that Petitioner advances on this appeal. West Virginia noted that the tax

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[8] The unargued assertion by the United States that there is "no logical reason" why the appropriateness of Maryland's tax on its own residents' income should depend on whether Maryland also taxes income earned by nonresidents is therefore critically mistaken and would, if adopted, effectively repudiate the entire concept of internal consistency. *See* U.S. Br. at 24.

burden on within-state transactions—*i.e.*, where the manufacturing and the wholesaling both occurred within the state—was 0.88 percent, while the tax burden on inbound transactions—*i.e.*, where the manufacturing occurred outside the state but the wholesaling occurred within the state—was only 0.27 percent. Just as Petitioner argues here, West Virginia maintained that there was therefore no discrimination against interstate commerce because the tax burden on commerce entering the state was lower than the rate on manufacturing inside the state. *Id.*

West Virginia's argument overlooked the fact that its 0.88 percent tax on manufacturing already imposed a burden on outbound transactions because many of the goods manufactured within the state were sold outside the state as well as inside it. This 0.88 percent outbound transaction tax combined with the 0.27 percent inbound transaction tax on property manufactured outside the state to create a combined tax burden of approximately 1.15 percent on cross-border transactions. Because this combined burden on interstate commerce exceeded the 0.88 percent tax burden on purely within-state commerce, the resulting tax scheme discriminated against interstate commerce and favored within-state commerce, just like a tariff.

The Court in *Armco* correctly pinpointed the discriminatory nature of the tax by applying the internal consistency test. *Id.* at 644. It noted that if every state copied West Virginia's tax scheme, property manufactured in one state and wholesaled in another would face a combined 1.15 percent tax burden, resulting from the 0.88 percent manufacturing tax plus the 0.27 percent wholesale tax. *Id.* Property

manufactured and wholesaled in the same state, however, would face only a 0.88 percent tax burden. *Id.* Because the math underlying this hypothetical nationwide tax compares the combined burden on cross-border activity against the tax burden on within-state commerce, it accurately captures the discriminatory structure of the West Virginia tax scheme.

The same reasoning applies to this case. If every jurisdiction copied Maryland's partial-credit tax scheme, all income earned by one state's resident in another state would be subject to a combined tax burden of 6.0 percent plus the county tax rate. Specifically, the state in which the income was earned would impose a 6.0 percent tax and the residence state would impose a tax equal to the county tax rate (*i.e.*, a before-credit tax of 4.75 percent plus the county tax rate, minus a credit of 4.75 percent for the tax paid to the state in which the income was earned). Meanwhile, all within-state income earned by a resident would be subject to a tax of 4.75 percent plus the county tax rate. The resulting combined tax burden on cross-border activity would exceed the tax on within-state transactions by approximately 1.25 percentage points.[9] Like the tax scheme in *Armco*, Maryland's tax scheme does not satisfy the internal consistency test, and the

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[9] As discussed above, the exact combined tax burden is slightly less than 1.25 percent because Maryland's tax should be considered to fall on the income that remains after paying the other state's income tax. *See supra* note 3. Such an adjustment is necessary for the internal consistency test to precisely track the concept of neutrality.

Maryland Court of Appeals' decision to strike it down may be affirmed on that basis. Pet. App. at 19-23.[10]

III. THE 1975 AMENDMENT ELIMINATING MARYLAND'S FULL TAX CREDIT ON OUTBOUND TRANSACTIONS FACIALLY DISCRIMINATES AGAINST INTERSTATE COMMERCE.

Finally, the Court may affirm on the ground that the specific legislative act that transformed Maryland's tax scheme from a full-credit to a partial-credit regime is itself facially discriminatory. Although the current tax regime would burden interstate commerce disproportionately regardless of the process that led to its enactment, the sequence of events highlights the essentially discriminatory nature of the scheme.

Prior to 1975, Section 290 of the Maryland tax code provided residents who earned income out of state a full credit for all taxes paid to another state. *See Blanton*, 390 Md. at 541. The statute read as follows:

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[10] One potential limitation of the internal consistency test is that it obscures the risk of discrimination that results even in a full-credit regime. Because the internal consistency test assumes that every state employs the same tax rate as the resident state, a full-credit regime would satisfy the internal consistency test even though such arrangements are in fact discriminatory when another state's income tax rate is less than the state of residence. It is particularly striking that Maryland's partial-credit regime fails the internal consistency test, even though that test validates a full-credit arrangement.

§ 290. Credit allowed residents.

> Whenever a resident individual of this State has become liable for income tax to another state ... the amount of income tax payable by him under this subtitle shall be reduced by the amount of the income tax so paid by him to such other state . . . .

Md. Code Ann., art. 81, § 290 (1957, 1975 Repl. Vol.).

In 1975, the Maryland legislature amended Section 290 to exclude from the credit any amounts owed for the county tax, thereby increasing the tax burden paid by Maryland residents on income earned from outbound transactions. *Blanton*, 390 Md. at 541-42. The relevant part of that legislative enactment read as follows:

> (b) . . . [W]ith respect to the taxable year 1974 and each taxable year thereafter, the credit provided for by this section operates to reduce only the State income tax payable under this subtitle and does not operate to reduce any local income tax imposed . . . .

Act of Feb. 11, 1975, ch. 3, 716 Md. Laws 7, 8, *available at* http://msa.maryland.gov/megafile/msa/speccol/sc2900/sc2908/000001/000716/html/am716--8.html (codified as amended at Md. Code Ann., art. 81, § 290(b)).[11]

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[11] The Maryland tax statute was recodified in 1988, and the relevant provisions are now set forth in Md. Code Ann., Tax-Gen. § 10-703, which provides in relevant part:

> (a) *In general.* — Except as provided in subsection (b) of this section, an individual may claim a credit only against

On its face, this amendment targets interstate commerce. It raises revenue for the state by placing an additional burden only on cross-border activity. The fact that the discrimination takes the form of a credit is immaterial under this Court's precedent. In *Maryland v. Louisiana*, 451 U.S. 725 (1981), for example, the Court considered a Louisiana tax scheme that imposed a tax on certain natural gas brought into the state but provided residents with a credit for certain other taxes paid. The Court struck down the scheme, observing that the credit for within-state taxes encouraged the recipients of the credit to engage in within-state commercial activity instead of engaging in interstate commerce. *Id.* at 756 (observing that the tax "unquestionably discriminates against interstate commerce in favor of local interests as the necessary result of various tax credits and exclusions"); *see also Scheiner*, 483 U.S. at 306 (Scalia, J., dissenting) ("A credit against intrastate taxes falls readily within the highly suspect category"); *Westinghouse Elec. Corp v. Tully*, 466 U.S. 388, 404 (1984) (noting that disallowing a tax credit would have the identical discriminatory economic effect as imposing a higher tax).

Just as a discriminatory export tariff is the mirror image of an import tariff, Maryland's decision to reduce the credit it provides its residents is the mirror image of Louisiana's discriminatory grant of a credit to residents for within-state taxes. Like Louisiana's

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> the State income tax for a taxable year in the amount determined under subsection (c) of this section for tax on income paid to another state for the year.

Md. Code Ann., Tax-Gen. § 10-703(a) (1988).

extension of a credit, Maryland's reduction of a credit has reduced the incentives for its residents to engage in commercial activity in other states. Both taxes are facially discriminatory. *See Maryland*, 451 U.S. at 756-57 (concluding that the Louisiana tax scheme is discriminatory "[o]n its face").

It is no defense for Petitioner to argue here that the intent of the 1975 amendment was merely to ensure that all Maryland residents "paid at least some taxes to support government programs." Pet. Br. at 41. Maryland pursued that goal in a constitutionally impermissible manner by singling out and deliberately increasing the tax burden on cross-border commercial activity. The circumstances giving rise to the amendment, therefore, are no different from those in which a state imposes a neutral retail sales tax on the in-state sales by resident and nonresident sellers only to find that some resident sellers pay no such tax because they sell exclusively outside the state. It would be facially discriminatory for the state to "fix" that problem by imposing an export tariff on out-of-state sales. Maryland's decision to reduce the credit for taxes paid on residents' out-of-state income is equally discriminatory on its face.

Because the 1975 amendment is a facially discriminatory piece of legislation, it is "virtually *per se*" invalid, unless the state can show that it has "no other means to advance a legitimate local purpose." *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338-39 (2007). Petitioner cannot satisfy that burden because there is no constitutional impediment to its local goal of taxing all Maryland residents to pay for the benefits they

receive. There is nothing discriminatory about a tax on the income of state residents wherever earned. Maryland, however, *cannot* tax the income of its residents wherever earned while also imposing a comparable tax burden on nonresidents, because the combination of those two taxes amounts to an unconstitutional burden on interstate commerce. The Maryland Court of Appeals therefore correctly determined that the 1975 amendment contravenes the Constitution. Pet. App. at 32, 34.

IV. PETITIONER'S CONCERNS REGARDING STATE SOVEREIGNTY ARE MISPLACED.

The Court should reject the various arguments raised by Petitioner and its supporting *amici* in favor of reversal. All of those arguments proceed from the misconception that Maryland's tax on the income of its residents can be considered in isolation from its tax on the income of nonresidents.

First and foremost, Petitioner errs in claiming that this case turns on Maryland's right to tax the income of its residents, wherever earned. *See* Pet. Br. at 2. It does not. There is nothing discriminatory about a neutral residence tax on the income of Maryland residents wherever earned. However, merely because Maryland has the right to tax residents does not mean that it has the right to do so in a manner that discriminates against interstate commerce. *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 203 (1994) ("State taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products, they are unconstitutional."). Petitioner improperly relies on *dicta* in *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989), which states that it is not the

purpose of the Commerce Clause to protect residents from the taxes of their own state. *See* Pet. Br. at 2, 42. Neither *Goldberg* nor any other case of this Court has held that a state has the right to tax its residents in a manner that discriminates against cross-border activity. To the contrary, the Court has expressly rejected that view. *W. Lynn Creamery*, 512 U.S. at 203.

Second, Petitioner is mistaken to suggest that affirming the judgment of the Maryland Court of Appeals requires this Court to hold that states, as a constitutional matter, must offer residents full credits for taxes paid to other jurisdictions. *See* Pet. Br. at 17, 26-27. To avoid discriminating against interstate commerce, states need not offer residents full tax credits. States may tax residents' out-of-state income as much as they like as long as they avoid simultaneously taxing nonresidents' in-state income at a rate that, combined with the tax on residents' out-of-state income, exceeds the tax on residents' in-state income. However, when a state imposes an income tax at comparable rates on residents' income earned out of state, residents' income earned within the state *and* nonresidents' income earned within the state, then at a minimum it must offer a full credit for taxes paid by residents to other jurisdictions to mitigate the discriminatory double burden that its tax system imposes on interstate commerce. A partial credit under those particular circumstances is insufficient.

Third, Petitioner's argument that the political process will safeguard against discrimination is misplaced. *See* Pet. Br. at 24-26, 41-43. The discriminatory nature of Maryland's tax scheme stems from the decision to tax the income of nonresidents.

Nonresidents have no electoral say in Maryland's tax on their income. There is no political mechanism to rectify the resulting discrimination against interstate commerce. Invalidating Maryland's discriminatory tax scheme under the dormant Commerce Clause is therefore a particularly appropriate means to protect interstate commerce from unconstitutional discrimination. *S. Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 767 n.2 (1945) ("[T]he Court has often recognized that to the extent that the burden of state regulation falls on interests outside the state, it is unlikely to be alleviated by the operation of those political restraints normally exerted when interests within the state are affected.").

CONCLUSION

For the foregoing reasons, the tax economists *amici* respectfully submit that the Court should affirm the judgment of the Maryland Court of Appeals.

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IN THE

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COMPTROLLER OF THE TREASURY OF MARYLAND,

Petitioner,

v.

BRIAN WYNNE, ET UX,

Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF FOR TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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IN THE

Supreme Court of the United States

No. 13-485

COMPTROLLER OF THE TREASURY OF MARYLAND,

Petitioner,

v.

BRIAN WYNNE, ET UX,

Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF FOR TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

STATEMENT OF INTEREST[1]

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. submits this brief as *amicus curiae*. Tax Executives Institute ("TEI" or "the Institute") is a voluntary, nonprofit association of

[1] No party or counsel for a party wrote this brief in whole or in part. No party, counsel for a party, or person other than Tax Executives Institute, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. TEI was organized in 1944 under the laws of the State of New York and is exempt from taxation under section 501(c)(6) of the Internal Revenue Code (26 U.S.C.). The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws, reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and defending Commerce Clause protections and the constitutional rights of business taxpayers.

The members of the Institute represent a cross section of the business community. The multi-jurisdictional companies represented by the Institute's membership are significantly affected by the rules governing state taxes generally, and especially those governing the allocation and apportionment of income among the various States. As a result, nearly all Institute members will be affected by the resolution of this case, which addresses the treatment of income earned from commercial activities conducted in an active business operating in interstate commerce. Unless the decision of the Court of Appeals of Maryland is affirmed, business taxpayers throughout the Nation will face substantial uncertainty, suffer heightened costs and burdens of compliance, and be at risk of duplicative taxation. As individuals who must contend daily with the interpretation and administration of the Nation's tax laws, the Institute's members have a vital interest in the proper disposition of this case.

SUMMARY OF ARGUMENT

The question presented in this case is whether the State of Maryland's failure to provide an effective

mechanism in its individual income tax to mitigate the risk of double taxation on income earned from commercial activities conducted outside the State violates the Commerce Clause of the United States Constitution. It does.

Under this Court's jurisprudence, a state tax violates the Commerce Clause if it discriminates against interstate commerce or subjects interstate commerce to the risk of cumulative taxes of several States. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977); *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938). Such taxation is proscribed because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation constitutes an "unreasonable clog on the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

Like most States, Maryland imposes an income tax on individuals. The tax has three parts: (1) a state income tax; (2) a county income tax; and (3) a tax on those subject to the state income tax but not the county tax (*i.e.*, non-residents of Maryland). Md. Code Ann., Tax-Gen. §§ 10-102, 10-103, 10-105(a), 10-106, 10-106.1.[2] Individual residents of Maryland are taxable on all income regardless of its source, while non-residents are taxable only on their income derived from Maryland sources. To mitigate double taxation

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[2] All parts of the Maryland individual income tax scheme are treated as state taxes. *Frey* v. *Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011) ("[T]he county tax levied under [Md. Code Ann., Tax-Gen.] § 10-103 and § 10-106 is a State tax.").

for Maryland residents, Maryland provides a credit against the state portion of its individual income tax for income taxes paid to other states. Md. Code Ann., Tax-Gen. § 10-703(a). A similar credit was provided for the county portion of the tax until 1975 when the General Assembly of Maryland repealed it. Chapter 3, Laws of Maryland 1975. The General Assembly has neither replaced that credit nor enacted another mechanism to mitigate the risk of multiple taxation on interstate business income subject to the county portion of the Maryland individual income tax.

The calculation of the Maryland individual income tax base largely follows that of the Internal Revenue Code. Under Subchapter S of the Internal Revenue Code, certain corporations can elect to be treated as "pass-through" entities whose income is not taxed at the corporate level, but rather is reported and taxed on a pro rata basis by the shareholders of the corporation. 26 U.S.C. §§ 1362(a), 1363, 1366 (such electing corporations are commonly referred to as "S corporations"). The items of income, loss, deduction, and credit generated by an S corporation retain their character and flow directly to the shareholders who are subject to tax at the shareholder level——as if the shareholders were directly operating the business of the S corporation. 26 U.S.C. § 1366(b). Maryland has adopted these federal provisions, and the items of income, loss, deduction, and credit of an S corporation, as well as the character of such items, become part of the shareholders' Maryland individual income tax computations. Md. Code Ann., Tax-Gen. § 10-107.

The income at issue in this case arose from the active conduct of an S corporation's multistate business. Maxim Healthcare Services, Inc. ("Maxim") provides home health, medical staffing, and wellness

services throughout the United States. The taxpayers, Brian and Karen Wynne, are Maryland residents who owned 2.4% of Maxim's stock in 2006, the taxable year at issue. Pursuant to Maxim's S corporation status, the Wynnes reported their pro rata share of the items of income, loss, deduction, and credit from Maxim's business on returns filed in 39 States, including Maryland. Maxim or its shareholders (or both) paid income tax in those 39 states.[3] The Wynnes claimed a credit on their Maryland income tax return for taxes paid to other States under Md. Code Ann., Tax-Gen. § 10-703(a). No such credit, however, was available to offset the county portion of the Maryland individual income tax.

States may tax interstate commerce without violating the Commerce Clause. *See Western Live Stock*, 303 U.S. at 254 ("It was not the purpose of the Commerce Clause to relieve those engaged in interstate commerce from their just share of state tax burden."). The Commerce Clause prohibits, however, state taxes and duties that hinder and suppress interstate trade by discriminating against or unduly burdening interstate commerce. *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992). In *Complete Auto*, this Court set forth a four-prong test for determining whether a State tax violates the limits imposed by the Commerce Clause. Under that test, a tax will be sustained only if (1) it is applied to an activity with a substantial nexus with the taxing State, (2) it is fairly apportioned, (3) it does not discriminate against interstate commerce, and (4) it is

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[3] Unlike Maryland, some States do not follow the federal income tax treatment of S corporations and tax such entities at the corporate level.

fairly related to the services provided by the State. 430 U.S. at 279.

The Commerce Clause applies to all state taxes that affect interstate commerce, regardless of their labels or on whom they are imposed. *See Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 574-75 (1997). Petitioner argues that merely labeling a state tax as a personal income tax on state residents eviscerates the Commerce Clause protections afforded interstate commerce. *See* Comptroller Br. 26-27. This is simply wrong and ignores the uniform application of the Commerce Clause to state taxes affecting interstate commerce established by this Court in *Complete Auto* and its progeny. This Court has applied the *Complete Auto* test to evaluate the constitutionality of a wide variety of state taxes, including taxes imposed against individual residents of a State. *See, e.g., Goldberg v. Sweet*, 488 U.S. 252 (1989).

Maryland's efforts to exclude a subset of interstate commerce—that earned by a pass-through entity—from the protections afforded by the Commerce Clause run counter to the Court's jurisprudence by exalting statutory form over substance. If the lower court's decision is reversed, business taxpayers would face the potential for future exceptions to the protections from overly burdensome taxation provided by the Commerce Clause. For example, a State might claim the Commerce Clause has no application to the taxation of business entities in the State of their commercial domicile thereby creating significant risk of multiple taxation. *See* U.S. Brief at 31 ("It is an open question whether States are constitutionally *required* to apportion the income of a domestic corporation."). (Emphasis in original.)

The county portion of Maryland's individual income tax fails to withstand Commerce Clause scrutiny required under *Complete Auto*. The second prong of that test requires a state tax to be fairly apportioned. *Complete Auto*, 430 U.S. at 279. This prong ensures "there is no danger of interstate commerce being smothered by cumulative taxes of several states." *Complete Auto Transit Inc. v. Brady*, 330 S.2d 268, 272 (1976). Under Maryland's scheme, the county portion of the tax fails the test because it does not provide a mechanism to mitigate the risk of duplicative taxation on income earned from interstate commerce. Such a risk, by itself, contravenes this constitutional restriction on States' taxing powers. *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939). The risk of double taxation alone violates the Commerce Clause; no actual double taxation need exist. "[T]he con-stitutionality of [one State's] tax should not depend on the vagaries of [another State's] tax policy." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 444 (1980). The Maryland taxing scheme in issue provides no relief from multiple taxation for income earned from the operation of a business operating in interstate commerce. The absence of such relief creates an unconstitutional risk that interstate commerce conducted by residents of Maryland will be unduly burdened. Accordingly, the decision below should be affirmed.

Petitioner argues that affirming the court below would infringe on Maryland's sovereign power to tax the entire income of it residents, "including income earned outside [its] borders." Comptroller Br. 17 (citing *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 463 (1995)). That position, however, ignores the restrictions imposed by the Commerce Clause on state taxes involving commerce conducted across state

lines. Indeed, the only income at issue in this case is commercial income earned by Maxim's business from activities conducted in the 39 States where it filed tax returns. No other income is at issue here.

None of the cases cited by Petitioner in support of its assertion that States are constitutionally free to tax any and all income of their residents address the Commerce Clause restrictions on a State's right to tax. *See, e.g.*, *Chickasaw Nation*, 515 U.S. 450 (treaty did not prohibit State from taxing income of tribal members living off reservation); *New York v. Graves*, 300 U.S. 308 (1937) (Due Process Clause did not bar New York from imposing income tax on rental and interest income of resident earned from real property located in New Jersey); *Lawrence v. State Tax Comm'n*, 245 U.S. 37 (1932) (neither the Due Process Clause nor the Privileges and Immunities Clause prohibited Mississippi from imposing its income tax on income earned by an individual from the construction of public highways in Tennessee). None of the foregoing cases address the application of the Commerce Clause limitations to a State's right to tax. The United State's argument that a State's relationship with its individual residents differs from its relationship with its domiciliary corporations is similarly misguided. This Court has applied Commerce Clause protections to individuals in the same manner as it has to corporations. *See, e.g.*, *Goldberg*, 488 U.S. 252.

In certain cases, the Commerce Clause's prohibition against overly burdensome multiple taxation of interstate businesses requires allocation of income in full to a single State. Thus, for a corporation, the domiciliary State may tax in full income derived from an unrelated business activity constituting a "discrete business

enterprise." *Exxon Corp. v. Dep't of Revenue of Wis.*, 447 U.S. 207, 224 (1980) (quoting *Mobil Oil*, 445 U.S. 425, 442, 439). A common example of fully allocable income is gain from the sale of a subsidiary or division that was unrelated to the operation of the corporation's main business. *See, e.g.*, *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 553 U.S. 16 (2008) (applying the "unitary business" doctrine to the sale of a division of a corporation). Requiring allocation of such income in full to a single State vindicates the Commerce Clause restrictions on States' taxing authority because it eliminates the risk of double taxation by constraining the ability of any State except the State of the corporation's commercial domicile to tax it. The income at issue in this case, however, is not fully allocable income.

Amicus the Multistate Tax Commission posits that the income generated by Maxim in the active conduct of its business is transformed into investment income when it passes through to its S corporation shareholders. Br. 4, 10, 11. The only income at issue for the Wynnes is business income from the operation of Maxim's multistate business. By virtue of Maryland law and its adoption of the federal treatment of S corporations, the character of Maxim's income did not change as it passed through to the Wynnes. It remains income from the active conduct of a multistate business and must be treated accordingly for purposes of analyzing the Commerce Clause limitations on Maryland's power to tax. The court below correctly applied the Commerce Clause limitations articulated by the *Complete Auto* test to Maryland's tax on that income and properly concluded that the absence of a mechanism in the county portion of the Maryland individual income tax to mitigate the risk of multiple taxation is unconstitutional.

ARGUMENT

I. THE COMMERCE CLAUSE REQUIRES STATES TO MITIGATE THE RISK OF MULTIPLE TAXATION OF BUSINESS INCOME EARNED IN INTERSTATE COMMERCE.

A. The Commerce Clause Applies to All State Taxes Affecting Interstate Commerce.

By allocating the Wynne's pro rata share of income derived from Maxim's commercial activities conducted in 39 States fully to the State of Maryland and subjecting it to the county portion of the state income tax without providing any mitigation against the risk of multiple taxation, Maryland violated the limits imposed by the Commerce Clause on States' ability to tax multistate businesses. U.S. Const. art. I, § 8, cl. 3.

Within our federal system of government, States retain broad authority to legislate and govern within their borders. Those powers, however, are not absolute. *See Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 449 (1827) ("[T]he taxing power of the states must have some limits."); *McCulloch v. Maryland*, 17 U.S. 316, 427 (1819) ("[T]he sovereignty of the state, in the article of taxation itself, is subordinate to, and may be controlled by the Constitution of the United States."). The Commerce Clause limits state power by acting as a brake against overly burdensome state regulation that would constitute an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

Under the Commerce Clause, state taxes may not discriminate against, nor unduly burden, interstate commerce. *Quill Corp. v. North Dakota*, 504 U.S. 298,

312 (1992) (citing *Philadelphia v. New Jersey*, 437 U.S. 617 (1978) and *Kassel v. Consolidated Freightways Corp. of Del.*, 450 U.S. 662 (1981)). The Constitution proscribes such taxation because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several states." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 335 (1977). Given the purpose and intent of the Commerce Clause, "[s]tate taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." *Freeman v. Hewitt*, 329 U.S. 249, 253 (1946). *See also Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938). Hence, a balance must be struck between a State's need for revenue to fund services provided to taxpayers and taxpayers' right to protection from overreaching tax authorities. This Court has long made "the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers." *Boston Stock Exchange*, 429 U.S. at 329.

In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), the Court encapsulated its earlier holdings and articulated a four-prong test for determining whether a state tax statute violates the Commerce Clause. In doing so, the Court overruled a line of earlier cases holding "that a tax on the 'privilege' of engaging in an activity in the State may not be applied to an activity that is part of interstate commerce." *Id.* at 278. "[A]ny consideration of the practical effect of the tax" was irrelevant to the application of that rule. *Id.* This rigid approach was referred to as the *Spector* rule, named for a case that applied the construct to a Connecticut corporate franchise tax on foreign

corporations. *See Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951).

Two cases following closely on the heels of *Spector* highlighted the untenable formalism of the rule and its disregard for the actual effects of a state tax on interstate commerce. In *Railway Express Agency v. Virginia*, 347 U.S. 359 (1954), the *Spector* rule was applied to an annual license tax imposed by Virginia on "gross receipts for 'the privilege of doing business in this State,'" which was measured by "'all receipts earned in this State on business passing through, into, or out of this State.'" *Id.* at 362, 367. Applying the *Spector* rule, the Court held that the tax unconstitutionally burdened interstate commerce because the tax was imposed on the privilege of doing business in the State and was measured by gross receipts generated in interstate commerce. *Id.* at 369. In response to this result, the Virginia legislature amended its law to impose a franchise tax measured by gross receipts from operations in Virginia. *Railway Express Agency v. Virginia*, 358 U.S. 434 (1959). The Court held that the revised statute did not violate the *Spector* rule despite the lack of any "real economic difference between" the two statutes. *Complete Auto*, 480 U.S. at 284.

"The *Spector* rule had come to operate only as a rule of draftsmanship, and served only to distract the courts and parties from their inquiry into whether the challenged tax produced results forbidden by the Commerce Clause." *Id.* at 285. Declaring that "the *Spector* rule does not address the problems with which the Commerce Clause is concerned," *id.* at 288, the Court overruled *Spector* and adopted a four-prong test designed to consider "not the formal language of the tax statute, but rather its practical effect." *Id.* at 280.

Petitioner's argument attempts to resurrect the formalism of *Spector* in the case of state individual income taxes, focusing on the labeling of the tax rather than its effects on interstate commerce. The position ignores the teaching of *Complete Auto* and seeks to reshape the long-recognized protections the Commerce Clause affords interstate businesses.

Specifically, the Court in *Complete Auto* held that a state tax will survive Commerce Clause scrutiny only if it (1) is applied to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State. *Id.* at 279. *Complete Auto* thus provides a framework for balancing competing interests among various States in which a taxpayer conducts business to determine whether a particular State's tax unduly infringes on interstate commerce.

The *Complete Auto* test has been applied to evaluate the constitutionality of a wide variety of state taxes. *See, e.g.*, *Quill Corp.*, 504 U.S. 298 (use tax); *Trinova Corp. v. Dep't of Treasury*, 498 U.S. 358 (1991) (state value-added tax); *Goldberg v. Sweet*, 488 U.S. 252 (1989) (telecommunications excise tax) (citing *D.H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988) (use tax)); *Wardair Canada Inc. v. Florida Dep't of Revenue*, 477 U.S. 1 (1986) (sales tax on fuel used in international commerce); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (severance tax); *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980) (corporate income tax); *Washington Dep't of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734 (1978) (business and occupation tax). The *Complete Auto* test focuses on the substance of the taxes in issue, not their form, and

applies to taxes assessed against resident individuals in the same manner as it applies to corporate entities. *See, e.g.*, *Goldberg*, 488 U.S. 252 (applying *Complete Auto* to an Illinois telephone excise tax imposed on a resident individual). *See also Camps Newfound/ Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (local property tax exemption for resident non-profit organizations found to violate Commerce Clause). Regardless of their labels, all of these state taxes implicated interstate commerce, making them subject to the limitations imposed by the Commerce Clause.

Petitioner argues that merely labeling a state tax as a personal income tax on state residents eviscerates Commerce Clause protections afforded interstate commerce. *See* Pet. App. 26-27. This is wrong because it fails to reflect the uniform application of the Commerce Clause to state taxes affecting interstate commerce as established by this Court in *Complete Auto* and its progeny. Interstate commerce is no less interstate commerce when accomplished by a corporation than when performed by a sole proprietor, partnership, or other business entity. Taxation of that commerce has been, and should continue to be, measured using the same constitutional yardstick—*i.e.*, *Complete Auto*'s four-prong test.

Carving out a subset of interstate commerce from the protections afforded by the Commerce Clause based on the individual or entity earning it is illogical and runs counter to the analysis and holding in *Complete Auto*. *See also Camps Newfound*, 520 U.S. at 584 ("We see no reason why the nonprofit character of an enterprise should exclude it from the coverage of either the affirmative or the negative aspect of the Commerce Clause."). If this theory were adopted, it

would "distract the courts and parties from their inquiry into whether the challenged tax produced results forbidden by the Commerce Clause," *Complete Auto*, 430 U.S. at 285, thereby inviting future exceptions to the protections from overly burdensome taxation provided by the Commerce Clause. For example, a State might claim the Commerce Clause has no application to the taxation of business entities in the State of their commercial domicile thereby creating a significant risk of multiple taxation. *See, e.g.*, U.S. Br. 31 ("It is an open question whether States are constitutionally *required* to apportion the income of a domestic corporation in that fashion."). (Emphasis in original.) The resulting uncertainty would raise the cost to business taxpayers of complying with their tax obligations, increasing the costs of administration for all stakeholders.

B. The Absence of a Mechanism to Mitigate Multiple Taxation of Income Earned in Interstate Commerce Violates the Commerce Clause.

Applying the *Complete Auto* test to the county portion of Maryland's individual income tax demonstrates that it cannot withstand Commerce Clause scrutiny. The taxpayer does not argue that there is a lack of substantial nexus or that the Maryland tax does not fairly relate to the services provided by the State. Rather, the taxpayer is concerned about the second and third prongs of the *Complete Auto* test.[4]

"The second and third parts of that [*i.e.*, the *Complete Auto*] analysis, which require fair appor-

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[4] Our analysis addresses only the fair apportionment prong of the *Complete Auto* test. Respondent and other *amici* adequately cover the discrimination prong of the test in their briefs.

tionment and nondiscrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce." *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992). The Commerce Clause does not prohibit States from taxing income earned in interstate commerce, but ensures that the burden imposed by the tax does not strangle business conducted across state lines. The Mississippi Supreme Court summarized the rule and its intent well in its opinion in *Complete Auto*, which was ultimately upheld by this Court:

> It will be noted that Taxpayer has a large operation in this State. It is dependent upon the State for police protection and other State services the same as other citizens. *It should pay its fair share of taxes so long, but only so long, as the tax does not discriminate against interstate commerce, and there is no danger of interstate commerce being smothered by cumulative taxes of several states.*

Complete Auto Transit Inc. v. Brady, 330 So.2d 268, 272 (1976). (Emphasis added.)

A state tax violates the Commerce Clause under the fair apportionment prong unless it provides a mechanism to mitigate the risk of duplicative taxation on income earned from interstate commerce. *Complete Auto*, 430 U.S. at 279. Such a risk, by itself, contravenes the constitutional restriction on States' taxing powers. *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939). *See also Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 444 ("[T]he constitutionality of [one State's] tax should not depend on the vagaries of [another State's] tax policy.").

Despite the high regard afforded apportionment as a method for avoiding unconstitutional multiple taxation on multistate business income, the Commerce Clause does not require States to use a single mechanism to address the risk of multiple taxation of business income. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978). In *Goldberg v. Sweet*, the Court analyzed the constitutionality of a telephone excise tax imposed on an individual by the individual's State of residence, *i.e.*, Illinois, and found no violation of the Commerce Clause in part because Illinois provided a tax credit for taxes paid to other States. 488 U.S. 252, 264 (1989) ("To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the Tax Act operated to avoid actual multiple taxation.") (Citations omitted.) The Maryland General Assembly eliminated any mechanism for mitigating double taxation for the county portion of the State's individual income tax system when it repealed its credit for taxes paid to other States in 1975, leaving in place an unconstitutional levy affording no relief against burdensome multiple taxation. Chapter 3, Laws of Maryland 1975.

Maryland provides neither apportionment relief for the county portion of its individual income tax nor a credit mechanism to afford relief from multiple taxation of multistate business income. The absence of any relief from multiple taxation creates an unconstitutional risk that interstate commerce conducted by residents of Maryland, including through a pass-through entity such as an S corporation, will be unduly burdened. The court below correctly held that the amendment to the county portion of the state income tax in 1975 eliminating the

credit for taxes paid to other States violated the Commerce Clause, and its holding should be affirmed.

C. The Cases Cited by Petitioner Do Not Address the Commerce Clause Limits Placed on State Taxing Powers.

Petitioner and its *amici* cite examples of taxpayers who challenged multiple taxation of income earned by the State of an individual's residence under the Due Process Clause of the Fourteenth Amendment, the Privileges and Immunities Clause, and the Equal Protection Clause among other constitutional provisions. *See* Pet. Brief at 18; U.S. Brief 12. None of those cases, however, involves the application of the Commerce Clause to a State's taxation of income generated in interstate commerce. *See, e.g., Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450 (1995) (treaty did not prohibit State from taxing income of tribal members living off reservation); *New York v. Graves*, 300 U.S. 308 (1937) (Due Process Clause does not bar New York from imposing income tax on rental and interest income of resident earned from real property located in New Jersey); *Lawrence v. State Tax Comm'n*, 245 U.S. 37 (1932) (neither the Due Process Clause nor the Privileges and Immunities Clause prohibits Mississippi from imposing its income tax on income earned by an individual from the construction of public highways in Tennessee).

Acting within the limits of one part of the Constitution, however, does not give States a free pass to ignore other constitutional requirements. As this Court has observed "[a] tax may be consistent with due process and yet unduly burden interstate commerce." *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 n.7 (1992). A state tax violates the Commerce Clause unless it provides a mechanism to mitigate the risk of

duplicative taxation on income earned from interstate commerce. *Complete Auto Transit Inc. v. Brady*, 480 U.S. 274, 269 (1977). Such a risk, by itself, contravenes this constitutional restriction on state power. *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939) ("The present tax, though nominally local, thus in its practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed."). *See also Freeman v. Hewitt*, 329 U.S. 249, 256 (1946) ("The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment.").

The income at issue in this case is solely business income generated from operation of Maxim's interstate business, and the prohibited risk of multiple taxation of that income has become a reality. Maxim is treated as an S corporation for both federal and Maryland income tax purposes. While S corporations are not generally subject to tax, their shareholders must include their pro rata share of the income, loss, deductions, and credits generated by the S corporation when computing their personal income tax liabilities. In addition to reporting their pro rata share of these tax items in their individual returns, the character of the items in the hands of the S corporation carries over to the shareholders as if the shareholders

had generated them in the first instance. 26 U.S.C. § 1366(b).[5]

Maryland has adopted the federal treatment of S corporations for purposes of its own tax system. "To the extent practicable, the Comptroller shall apply the administrative and judicial interpretations of the federal income tax law to the administration of the income tax laws of this State." Md. Code Ann., Tax-Gen. § 10-107. Thus, an individual taxpayer in Maryland must include his or her pro rata share of S corporation income in his or her Maryland individual income tax computation, and the character of that income is the same in the hands of the individual taxpayer as it was in the hands of the S corporation. 26 U.S.C. § 1366(b).

The county portion of the Maryland individual income tax at issue in this case is being assessed against the Wynnes' pro rata share of Maxim's items of income, loss, deduction, and credit that flow directly to their Maryland income tax return and are subject to tax at the shareholder level. This income, which was undeniably generated in interstate commerce, retains its character even though taxed on the Wynnes' Maryland individual income tax return. The substance of the tax is a tax on the commercial income of Maxim, albeit reported by and taxed against the Wynnes.

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[5] "The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) [*i.e.*, the S-corporation's income or loss] shall be determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation."

Overturning the decision of the court below would cast doubt on the continuing applicability of the long line of cases supporting the need for a mechanism to mitigate cascading state taxation on income earned by interstate businesses. Degrading existing Commerce Clause protections would expose interstate commerce to the "danger of . . . being smothered by cumulative taxes of several states" that existed when the first multistate businesses entered the American economy well over a century ago. *Complete Auto Transit Inc. v. Brady*, 330 So.2d 268, 272 (1976). This Court should not make a ruling that calls these principles into question.

II. The Commerce Clause Prohibition on States Taxing Value Earned Outside Their Borders Requires Allocation in Full for Nonbusiness Income.

Certain income generated by a business is so divorced from the company's general business operations that the Constitution requires it to be excluded from the apportionable tax base and allocated in full to a single State. *See Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 780 (1992) (holding that a sale of stock in a subsidiary was nonbusiness income allocable in full to the State of commercial domicile); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) (dividends, interest, and capital gains from subsidiaries found to be nonbusiness income allocable to State of commercial domicile). That income, commonly referred to as nonbusiness income, is allocated in full to a corporation's State of commercial domicile (or in the case of real estate, to the State in which the real property is located). But the requirement to allocate nonbusiness income to a single State is itself a form of

Commerce Clause protection because it results in that income being taxed by only a single State—the State of the corporation's domicile (or situs of real property).

Amicus the Multistate Tax Commission posits that the income generated by Maxim in the active conduct of its business is transformed into investment income when it passes through to its S corporation shareholders. Br. 4, 10, 11. The income generated by Maxim in this case is not nonbusiness income. It arose from Maxim's operation of an active multistate business that provides healthcare and wellness services across the Nation. By virtue of Maryland law and its adoption of the federal treatment of S corporations, the character of Maxim's income did not change as it passed through to the Wynnes. It remains income from the active conduct of a multistate business and must be treated accordingly for purposes of analyzing the Commerce Clause limitations on Maryland's power to tax.

The holding of the court below does not alter the rules applicable to nonbusiness income. The income Maryland seeks to tax in this case is limited to income generated by a multistate business that was subject to tax in multiple States. Business taxpayers have long relied on these decades' old precedents to guard against extraterritorial taxation that constitutes an "unreasonable clog on the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935). Reversing the decision of the court below would upend those Commerce Clause protections, creating substantial uncertainty that would cause businesses with multistate operations to suffer heightened costs and burdens of compliance and to be at risk of cascading taxation.

CONCLUSION

For the foregoing reasons, as well those in Respondent's brief, the decision below should be upheld.

Respectfully submitted,

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AMICUS CURIAE BRIEF

No. 13-485

IN THE
Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
Petitioner,

v.

ROBERT WYNNE, ET UX.,
Respondent.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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BRIEF OF TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

INTEREST OF *AMICUS CURIAE*[1]

Tax Foundation submits this brief as *amicus*

[1] Pursuant to Supreme Court Rule 37.6, counsel for *Amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *Amicus* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *Amicus* represents both that all parties were provided notice of *Amicus*'s intention to file this brief at least 10 days before its due date and that all parties have filed letters with the clerk of the Court granting blanket consent to the filing of *amicus* briefs.

curiae in support of Respondent in the above-captioned matter.

The Tax Foundation is a non-partisan, non-profit research organization founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., we seek to make information about government finance more accessible to the general public. Our analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability. The Tax Foundation's Center for Legal Reform furthers these goals by educating the legal community about economics and principled tax policy.

This Court's decision will provide guidance on the line between states' power to shape their tax systems and the limits on that power guarded by the Commerce Clause. Because *Amicus* has testified and written extensively on the scope of state tax authority and because this Court's decision may impact tax policy developments in other states, *Amicus* has an institutional interest in this Court's ruling.

SUMMARY OF ARGUMENT

Maryland's failure to allow a full credit for taxes paid to other states violates the *Complete Auto* four-part test and substantially burdens interstate commerce. There are also substantial reliance interests at stake in this case because tax practitioners and experts have long understood that states are required to offer a credit for taxes paid to other states as a matter of constitutional compliance, and businesses have been entering into interstate transactions for decades based on this assumption.

Maryland's argument that S Corporations are not protected by the dormant Commerce Clause when the

income is taxed by the taxpayer's state of residence would have wide-ranging, devastating consequences for the business community. There is no constitutional reason why the constitutional limitations on states' authority to tax interstate transactions should be suspended for S corporations, particularly as S Corporations have been the largest business entity type in the United States since 1997.

ARGUMENT

I. STATE TAXATION OF INTERSTATE INCOME WITHOUT A CREDIT FOR TAXES PAID TO OTHER STATES RESULTS IN DISCRIMINATORY TAXATION OF INTERSTATE INCOME AND UNDERMINES SIGNIFICANT RELIANCE INTERESTS.

Taxpayers and states rely on this Court's four-part *Complete Auto* test to evaluate whether a state tax practice violates the Commerce Clause. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). *Complete Auto* held that a tax will survive a Commerce Clause challenge if the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." *See id.* at 279. If a tax violates any of the four prongs, then the tax violates the Commerce Clause and is unconstitutional.

Tax practitioners and experts have long understood that if two or more states tax the same income, then the states have to offer a credit for taxes paid to the other state, since otherwise taxpayers will face multiple taxation on interstate income but not in-state income in violation of *Complete Auto*'s third

prong. As just one example, the preeminent authority in State and Local Tax, Professor Walter Hellerstein, writes in his textbook that the Commerce Clause requires a credit for taxes paid to other states since otherwise multiple taxation would result, with interstate activity being taxed more than intrastate activity. *See* WALTER HELLERSTEIN, STATE TAXATION ¶ 20.10 (3d ed. 2014). Every state with a broad-based income tax consequently offers a credit for income taxes paid to other states, not out of an altruistic willingness to forego taxes on income taxed by sister states, but grudgingly in the belief that it is constitutionally required to prevent multiple taxation.[2]

A. Maryland's Failure to Provide a Local Income Tax Credit for Taxes Paid to Another State Violates the Commerce Clause.

Maryland's tax law punishes taxpayers for earning income in other states instead of earning it wholly in Maryland. Maryland wants its subordinate political creations (counties and one city, Baltimore) to tax a Maryland resident's income in a manner

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[2] While this case involves county and city income taxes, the counties' taxes are authorized and defined by state statute, collected on the state tax form, and administered by state officials. Further, the counties and cities themselves are creations of the state government, with their revenue powers defined by the state constitution and state law. More to the point, there is no workable or justifiable reason why state-authorized but county-level income taxes would be permitted to use taxation to punish interstate investment but states cannot. States will certainly construe a decision by this Court as applying to state taxes. It should make no constitutional difference that the tax at issue is technically a county income tax.

whereby interstate income is taxed multiple times by both the Maryland entity and by sister states. A Maryland resident earning otherwise identical income wholly within Maryland is taxed only once. A non-resident who earns income in another state is taxed only once. A non-resident who earns income in more than one state is taxed only once, since other states provide a credit for taxes paid to another state. Maryland's statute uniquely disadvantages Maryland residents who earn interstate income. Had the Wynnes' income been earned purely in-state, they would have paid less in taxes to Maryland and not been subject to multiple taxation on the same dollar of income.

The Commerce Clause prohibits states from imposing a tax on activity out-of-state while leaving identical activity in-state untaxed. *See Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977) (invalidating a New York tax imposed solely on activity out-of-state while leaving identical activity in-state untaxed); *Westinghouse Elec. Co. v. Tully*, 466 U.S. 388 (1984) (invalidating a New York scheme exempting activity in-state while simultaneously imposed a tax on identical activity out-of-state); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating a Hawaii tax imposed on a category of products but exempting activity in-state); *Am. Trucking Ass'n v. Scheiner*, 483 U.S. 266 (1987) (invalidating a Pennsylvania scheme imposing fees on all trucks while reducing other taxes for trucks in-state only); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (invalidating an Ohio tax credit to all ethanol producers but disallowed for non-Ohio producers); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (invalidating a Massachusetts general

tax on dairy producers where the revenue was then distributed to domestic dairy producers); *Camps/Newfound/Owatanna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (invalidating Maine's denial of the general charitable deduction to organizations that primarily serve non-Maine residents). *But see Dep't. of Revenue of Ky. v. Davis*, 553 U.S. 328 (2008) (upholding Kentucky's exclusion from tax of interest earned from its state bonds, but not other states bonds, on the grounds that Kentucky is acting as a market participant no different from any other bond issuer).

States certainly have a desire to encourage in-state investment but the Commerce Clause forbids states from achieving these ends by punishing with multiple taxation those who choose to participate in the interstate economy. Individuals and businesses have been working across state lines and entering into large, complicated business arrangements for decades believing that they are safe from multiple taxation. If Maryland's tax law is upheld, then it would open the flood gates to allow every state with a broad-based income tax to deny its residents a credit for taxes paid to other states.

The Comptroller argues that since the Wynne's are Maryland residents, Maryland may tax their income earned both in-state and out of state without offering a credit for taxes paid to other states. The Comptroller's argument would effectively nullify the dormant Commerce Clause when the tax law at issue discriminates against a state's own resident. This argument confuses the dormant Commerce Clause, which protects interstate commerce from discrimination by the states, with the Privileges and Immunities Clause, which protects nonresidents from

discrimination. The primary inquiry for the dormant Commerce Clause is whether *interstate commerce* is burdened, not whether the law in question discriminates against a resident or nonresident of a state. Here, the Maryland law discriminates against interstate commerce because the Wynnes' business income was taxed at a higher effective rate due solely to the fact that it was earned out of state.

B. Maryland Power to Tax Residents' Income Earned in Other States is, and Ought to Be, Limited.

The Comptroller argues that mandating a credit for taxes paid to other states in this case leads to "the perverse effect" of allowing some taxpayers to get all the benefits of being a Maryland resident without paying any income taxes. *See* Pet. at 12. First, this is not factually true in this case since the Wynnes pay substantial Maryland taxes, nor in general because Maryland's power to tax Maryland-sourced income would be unthreatened. What is at issue in this case is Maryland's taxation of income sourced *to other states* without offering a credit to mitigate multiple taxation. States should not be constitutionally permitted to subject interstate commerce to multiple taxation simply because the person being taxed is a resident of the state. Second, Maryland along with every state and the federal government allow certain taxpayers to receive benefits without necessarily paying income taxes. In 2011, 37 percent of all federal tax filers in the United States owed no federal income taxes after deductions and credits. *See* TAX FOUNDATION, PUTTING A FACE ON AMERICA'S TAX RETURNS 22 (2013), http://taxfoundation.org/slideshow/putting-face-americas-tax-returns. This a common policy decision that allows some individuals

to reap the benefits of government while also granting them a break on income taxes.

This Court should take this opportunity to affirm the decision below and send a message to other states that *Complete Auto* means what it says and that a state cannot violate the dormant Commerce Clause solely because the person or business being taxed is a resident of the state.

C. The Relevant Inquiry is Not Whether the Taxpayer is a Resident, but Whether the Tax is on Interstate Income.

The Comptroller asserts that the internal consistency prong of the *Complete Auto* test has not previously been applied to the individual income taxes of residents before the Maryland Court of Appeals' decision. *See* Pet. at 9. Therefore, the Comptroller argues, the application of the internal consistency test was unprecedented. The Comptroller's argument ignores the fact that this Court has applied the internal consistency test wherever interstate transactions are at issue. *See, e.g.*, *Amer. Trucking Assocs. v. Mich. Public Serv.*, 545 U.S. 429, 437 (2005).

What the Comptroller misunderstands is that the Court of Appeals did not apply the internal consistency test because Maryland fully taxed a resident, it applied the test because Maryland fully taxed a resident *on business income earned in 39 states*. Credits and deductions are certainly a matter of legislative grace with respect to Maryland's taxation of income earned wholly within Maryland by Maryland residents with no interstate implications. *See* Pet. at 9 (arguing that the Commerce Clause does not protect residents from discriminatory taxation of their in-state income by their state of residence). But

when Maryland taxes income that *all other states would properly source as being earned outside Maryland*, the internal consistency inquiry is warranted.

D. Income Earned via S Corporations is Not Excluded from Commerce Clause Protections.

The Comptroller argues that the owners of S Corporations are not protected from discriminatory taxation by their state of residence under the dormant Commerce Clause. *See* Pet. at 9. This is an important point because S Corporations now account for the vast majority of business entities in this country. S Corporations became the most common corporate entity back in 1997 and now account for at least 3.3 million income tax returns filed. *See, e.g.*, Internal Revenue Service, *S Corporation Returns*, http://www.irs.gov/uac/SOI-Tax-Stats-S-Corporation-Statistics.

If the Comptroller's argument were to win the day, it would open the door for every state in the country to tax S Corporation income at a higher rate than intrastate C Corporation income simply because the income flows through to the individual rather than being taxed at the corporate level. This Court should make it clear that states may not discriminate against interstate commerce simply because an S Corporation's income flows through to an individual.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that this Court affirm the decision of the Maryland Court of Appeals.

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